88-1144

FILED
JAN 11 1988
JOSEPH F. SPANIOL, JR.
CLERK

No. _____

IN THE

Supreme Court of the United States

OCTOBER TERM, 1988

PENTHOUSE INTERNATIONAL, LTD. and
BOARDWALK PROPERTIES, INC.,
Petitioners,

v.

DOMINION FEDERAL SAVINGS & LOAN ASSOCIATION,
MELROD, REDMAN & GARTLAN, P.C., and
QUEEN CITY SAVINGS & LOAN ASSOCIATION,
Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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QUESTION PRESENTED

Whether, in this leading "lender liability" case, the court of appeals improperly reversed a $128.7 million judgment by fashioning general commercial law in violation of *Erie R. Co.* v. *Tompkins*, 304 U.S. 64 (1938), without even considering well-established state law to the contrary, and by engaging in impermissible factfinding on appeal when this Court's recent decisions required a remand to the district court.

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OPINIONS BELOW

The opinion of the court of appeals is reported at 855 F.2d 963 (Pet. App. 1a). The opinion of the district court is reported at 665 F. Supp. 301 (Pet. App. 67a). The district court's modification of its judgment is not reported (Pet. App. 62a). The district court's opinion denying defendants' motion for a new trial is reported at 678 F. Supp. 61 (Pet. App. 56a).

JURISDICTION

The judgment of the court of appeals was entered on August 26, 1988 (Pet. App. 92a). On October 13, 1988, the

court of appeals denied a timely petition for rehearing (Pet. App. 94a). The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATUTE AND RULE INVOLVED

The Rules of Decision Act, 28 U.S.C. § 1652, provides:

> The laws of the several states, except where the Constitution or treaties of the United States or Acts of Congress otherwise require or provide, shall be regarded as rules of decision in civil actions in the courts of the United States, in cases where they apply.

Rule 52(a) of the Federal Rules of Civil Procedure provides in relevant part:

> In all actions tried upon the facts without a jury or with an advisory jury, the court shall find the facts specially and state separately its conclusions of law thereon, and judgment shall be entered pursuant to Rule 58 . . .. Requests for findings are not necessary for purposes of review. Findings of fact, whether based on oral or documentary evidence, shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge of the credibility of the witnesses . . .. It will be sufficient if the findings of fact and conclusions of law are stated orally and recorded in open court following the close of the evidence or appear in an opinion or memorandum of decision filed by the court. . . .

STATEMENT

Penthouse International, Ltd. and its subsidiary Boardwalk Properties, Inc. (collectively "Penthouse") obtained a written mortgage loan commitment in June 1983 from Queen City Savings & Loan Association ("Queen City") for a $97 million mortgage loan. The loan

proceeds were to be used to finance Penthouse's completion of a hotel and casino project in Atlantic City, New Jersey.

Under the loan commitment agreement, Queen City was the lead lender, lending $7 million itself; Penthouse was to obtain other lenders who would provide an additional $90 million. The contract expressly provided that "the decision of the Lender's counsel as to whether all conditions of the commitment have been met shall be final . . ." (J.A. 92) and that the parties' rights would be governed by New Jersey law (J.A. 94).[1]

By the fall of 1983, twelve financial institutions had agreed to participate in the loan to the extent of $62 million. On November 21, 1983, Dominion Federal Savings & Loan Association ("Dominion") agreed with Queen City to participate in the loan to the extent of the remaining $35 million.[2] Dominion and Queen City further agreed that "the administration of the Agreement together with all final approvals and decisions shall be rendered solely by Queen City and its legal counsel, in their sole discretion, based upon discussions with Dominion . . .." (Pet. App. 96a.)

Because its lending limit under federal law was $18.5 million, Dominion had to sell subparticipation interests to reach its $35 million commitment. On December 2, 1983, Community Savings and Loan Association ("Com-

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[1] "J.A." refers to the Joint Appendix in the court of appeals.

[2] Because Penthouse preferred to deal directly with only one lead lender, it did not sign any agreement with Dominion directly, but gave Dominion a letter agreeing that Dominion would be a "co-seller" for the participation syndicate. Penthouse also paid Dominion $175,000 in fees for its participation. (Pet. App. 98a.)

munity") agreed to purchase $17.5 million of Dominion's participation.

On November 21, 1983, the same date that Dominion agreed to participate in the loan, officers of Penthouse and Queen City agreed in a letter signed by each that the "Commitment Expiration Date" would be extended to December 1, 1983, to take account of the fact that the original 120-day period had already expired. (Pet. App. 100a.) At the same time, Queen City stated in a letter to Penthouse that "[p]ursuant to our arrangements with our participants, we have set February 1, 1984 as the targeted closing date of this loan." (Pet. App. 99a.) (The original agreement between Queen City and Penthouse had provided that "closing" was to occur on or before the "Commitment Expiration Date." (J.A. 90.)) Also on November 21, Queen City's outside attorney wrote to Penthouse's counsel stating that on the basis of a "cursory review" of the legal services needed and discussions with Penthouse's counsel, "it is agreed that we shall close this loan no earlier than February 1, 1984 or later than March 1, 1984." (Pet. App. 101a.) Relying in part on this correspondence, the court of appeals would later determine that the parties had set March 1, 1984, as the expiration date of the loan commitment. (Pet. App. 28a-29a.)

During the months that followed, the parties began preparing for the closing of the loan. Representatives of Penthouse and Queen City met on several occasions in January to review the status of the loan and to move it toward closing. Dominion representatives did not attend these meetings, nor did they request to do so.

In early February 1984, Community began having second thoughts about participating in the loan and communicated its reservations to Dominion. In response to a loan

broker's objection to Community's unorthodox efforts to underwrite the loan after making its commitment, Dominion's Chairman of the Board replied: "Screw good faith. We're going to do it our way because we're the co-leader." (Pet. App. 74a-75a, 76a-77a.) The next day, Dominion retained Phillip Gorelick, Esq., a partner with the Washington, D.C. law firm of Melrod, Redman & Gartlan. (Pet. App. 14a.) Gorelick attended a preclosing meeting held on February 9, 1984. Beginning at that meeting and continuing into March 1984, he made a series of escalating demands on Penthouse relating to loan documentation, satisfaction of closing conditions, and his firm's role and the payment of its fees.

Despite Penthouse's continuing efforts to comply with these requests, Dominion never tendered loan documents to Penthouse or its counsel for their review. Penthouse ultimately concluded that Dominion would refuse to close. In June 1984, Penthouse therefore filed a diversity action in the Southern District of New York against Dominion and Gorelick's firm, seeking damages against Dominion for anticipatory breach of contract, and damages against Gorelick's firm for fraud. Dominion filed a third-party complaint against Queen City, claiming that Queen City should be liable to Dominion for any liability that Dominion might incur in Penthouse's suit against it.

The District Court's Opinion. After a three-week bench trial, the district court issued its opinion holding Dominion liable for an anticipatory breach of the loan commitment. (Pet. App. 67a.) The district court awarded Penthouse approximately $128.7 million, and awarded Queen City nearly $7.7 million (plus interest and costs) for the damages caused by Dominion's breach. In addition, the court dismissed with prejudice Dominion's third-party claim against Queen City. (Pet. App. 65a.) In a later

order, the court held that Gorelick's firm was jointly and severally liable for the damages awarded to Penthouse. (Pet. App. 62a.)

In holding Dominion and Gorelick's firm liable to Penthouse, the district court determined that, by early February 1984, Dominion had begun to receive indications that Community was uncomfortable about participating in the loan. (Pet. App. 75a-76a.) (If Community had withdrawn, Dominion would still have been bound under its agreement with Queen City to lend $35 million, an amount in excess of its legal lending limit.) Dominion then embarked on a course of conduct, starting with the preclosing meeting on February 9, 1984, and continuing into March 1984, that constituted an anticipatory repudiation of its participation commitment through "a clear refusal to proceed to closing unless conditions beyond those required by the Loan Commitment were first met." (Pet. App. 87a.)

In reaching this conclusion, the district court made detailed findings of fact, including the following:

1. At the preclosing meeting held on February 9, 1984, Gorelick stated that there were numerous problems with the loan and that the documents already prepared by and on behalf of the lenders were "idiotic." (Pet. App. 78a.) He presented a lengthy list of documents and other items he wanted to see before he would recommend that his client close the deal. The district court found, however, that "Gorelick expressed more concern with Dominion's ability to 'participate out' its share of the Loan Commitment . . . than with closing the deal." (Pet. App. 79a.)

2. Also at the February 9 preclosing meeting, Gorelick demanded that his firm be given the responsibility to prepare the loan documents, and that he be paid legal fees and a $150,000 "bonus." Penthouse yielded to

this demand by giving Gorelick's firm responsibility for preparing the documents needed for closing, subject to the ultimate approval of Queen City's counsel. Gorelick was "abusive" to Queen City's counsel and was at first "unresponsive" when asked how long it would take him to redraft the documents; he finally responded that he did not know if thirty additional days would be sufficient (Pet. App. 79a-81a), thereby indicating that the documents would not be ready until at least mid-March.

3. After the preclosing meeting, Gorelick did nothing to prepare the loan documents other than write "rough drafts" of the promissory note, and a mortgage and deed of trust, which were never sent to anyone for review. Gorelick admitted that Penthouse had delivered a roomful of documents in response to Dominion's requests (J.A. 1113-14), and the district court found "completely incredible" Gorelick's claim that he never completed the documents because he was waiting for more information. Rather, upon consideration of the testimony the court found that he was "waiting . . . . for the deal to fall apart." (Pet. App. 81a.)

4. In February 1984 and afterwards, Gorelick insisted on amendments to a lease agreement (termed the "Helmsley lease") concerning certain property involved in Penthouse's casino project. Although certain amendments to the lease were required to meet the loan commitment's closing conditions, the district court found that many of Gorelick's proposed amendments in fact were not required by the loan commitment. (Pet. App. 82a, 87a.) The court further found that "the entire matter could have been resolved in time to close the deal before March 1, 1984." (Pet. App. 74a.)

5. Dominion, through Gorelick's firm, made "never ending" requests for information throughout February

and March 1984, to which Penthouse repeatedly made efforts to respond. (Pet. App. 81a-84a.) Dominion "further demanded numerous changes in the way the entire deal was to be structured, the parties involved, and other changes not required by the Loan Commitment." (Pet. App. 84a.)

6. On March 6, 1984, representatives of Penthouse and Dominion met. Dominion "insisted that it replace Queen City as the exclusive lead lender," even though the district court found that "Dominion had no intention of doing anything with the loan except cheating plaintiffs out of the commitment fee." (Pet. App. 87a-88a.)

7. Dominion insisted on several other conditions directly contrary to or not required by the loan commitment, including (i) that a hotel management agreement be entered into prior to closing instead of after closing as provided in the original loan commitment (J.A. 103) and (ii) that Penthouse replace its construction manager with a firm having a "personal relationship" with members of Gorelick's firm. (Pet. App. 87a.)

8. Finally, the district court found that as of the pre-closing meeting on February 9, 1984, all of the twenty conditions to closing specified in the loan commitment "had been met, waived, or were in a position to have been met by the date set for closing the loan." (Pet. App. 85a.) The district court elsewhere explained that, at two status conferences in January 1984, counsel for Queen City, the lead lender, had "waived" certain of the conditions by agreeing to substitute arrangements that Queen City "deemed sufficient," found to be "adequate compliance," or deemed "acceptable." (Pet. App. 71a-74a.) These conferences were not attended by Dominion or other participating banks, who had not "sought to become involved

in reviewing the Queen City commitment conditions, leaving that solely to the lead lender and its counsel." (Pet. App. 71a.)

Based on these findings, the district court held that Dominion's conduct amounted to an anticipatory repudiation of the loan commitment and "an unambiguous refusal to close." (Pet. App. 88a.) It also found that Gorelick had been hired to "bully and intimidate" Penthouse into delaying the loan until Community could be replaced or the commitment expired. (Pet. App. 78a.) In a later opinion, the district court held Gorelick's firm jointly and severally liable for the judgment against Dominion because of its "active fraud" in not disclosing the "true nature of its agency, *i.e.*, to scuttle the deal . . . ." (Pet. App. 64a.)

The Decision of the Court of Appeals. The court of appeals reversed and remanded with instructions to dismiss Penthouse's complaint. (Pet. App. 55a.) In holding that Dominion had not committed an anticipatory breach, it relied on four key conclusions involving both findings of fact and conclusions of law.

First, the court of appeals found that in light of the parties' written extension of the "loan expiration date" to December 1, 1983, and the letter from Queen City's counsel stating that closing would be "no later than March 1, 1984," the parties had reached an agreement that the loan commitment would expire on March 1, 1984. (Pet. App. 28a-29a.)[3] While stating that it was "simply construing]

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[3] While recognizing that the district court had made no finding regarding when the loan commitment expired, the court of appeals thought the district court at least implicitly found that March 1 was the closing date in view of its comment that certain title problems relating to the Helmsley lease "could have been resolved in time to close the deal before March 1, 1984." (Pet. App. 74a, 29a.)

relatively unambiguous documents" (Pet App. 30a), the court of appeals relied on extrinsic evidence concerning the actions of certain loan participants after March 1, Gorelick's discussions with Penthouse's president in late February 1984, and what it termed Penthouse's "indirect" acknowledgement of a March 1 expiration date in its complaint. (*Id.*) The court of appeals cited several New Jersey cases discussing general principles of contract construction, but cited no principles of New Jersey law regarding the significance of contractually-set dates for performance or the effect of the parties' conduct on the expiration of a loan commitment.

Second, the court of appeals had to "acknowledge that the parties' conduct in continuing to negotiate after March 1st may be consistent with an implied extension of the expiration date." (Pet. App. 29a-30a.) It summarily dismissed this possibility, however, on the grounds that it had to enforce the parties' contract as stated in "unambiguous" documents and that "we do not believe that our conclusion is at odds with the parties' expectations." (Pet. App. 30a.) The court cited no New Jersey or other authority in concluding that there was no implied extension. Nor did it consider the effect on the expiration date under New Jersey law of its finding that "[e]ven after the commitment expired, Dominion indicated its continued interest in the transaction and maintained steady contact with Penthouse." (Pet. App. 53a.)

On the basis of these first two conclusions, the court of appeals next held that any conduct of Dominion or Gorelick occurring after March 1, 1984—which it thought to be the expiration date—could not be taken into account in determining whether there was an anticipatory breach and that the district court erred as a matter of law in

considering such post-March 1 conduct.[4] (Pet. App. 32a.) Accordingly, it found that there was no anticipatory breach under New Jersey law because, prior to March 1, 1984, Dominion did not make a "clear and unequivocal declaration" (the "anticipatory breach" standard under New Jersey law) that it would not close the loan unless new conditions not contained in the loan commitment were satisfied. (Pet. App. 32a-36a.)

Finally, the court of appeals held that no anticipatory breach could have occurred because the evidence showed that Penthouse could not have satisfied material closing conditions by March 1, 1984, absent a waiver of those conditions. (Pet. App. 38a.) It then held that Queen City's "waiver" of certain preclosing conditions, in favor of "substituted arrangements" or "substituted performance," was ineffective because Queen City as lead lender did not have the authority in the first instance to make "material changes" under the participation agreements with other participating lenders. (Pet. App. 40a.) It reached this conclusion by construing the terms of the loan commitment agreement and participation agreement.[5]

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[4] The court of appeals explained that the district court had cited four examples of Dominion's conduct in insisting upon new conditions to closing which could give rise to an anticipatory breach. It believed that the only one occurring before March 1, 1984, was Gorelick's demand that Penthouse obtain amendments to the Helmsley lease. (Pet. App. 33a.) One of the district court's other examples, the demand for a hotel management agreement, was among the thirty-five items on a list presented to Penthouse on February 29, however. (J.A. 1849-50.)

[5] Because the court of appeals concluded that Queen City had no authority to "waive" closing conditions, it held that Queen City could not be liable for breach of fiduciary duty to Dominion since "no waiver occurred" that could be given legal effect. (Pet. App. 47a.)

At the close of its opinion, the court of appeals also addressed the district court's conclusion that Gorelick's firm should be held liable for fraud. It concluded that the evidence did not establish a "basis to conclude that Gorelick or Dominion harbored a secret intent not to proceed on February 9-10 or otherwise," and that the district court "clearly erred" in finding that Gorelick was attempting to kill the deal. (Pet. App. 53a-54a.)

The court of appeals denied Penthouse's petition for rehearing on October 13, 1988. (Pet. App. 94a.)

REASONS FOR GRANTING THE WRIT

This case calls for the exercise of the Court's supervisory authority. The court of appeals disregarded its responsibility under *Erie R. Co.* v. *Tompkins*, 304 U.S. 64 (1938), fashioned general law on the basis of unfounded perceptions about syndicated loan transactions, and contradicted the controlling state law it should have applied. In the process, the court of appeals further disregarded the limits of its appellate power by making factual findings on matters not determined by the district court when, as this Court has made clear, it had a duty to remand the case.

These errors, which would merit the Court's attention in their own right, are of special consequence here. This is one of the leading cases in the development of "lender liability" law and it has been followed closely.[6] Numerous

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[6] The number and magnitude of lender liability cases increased dramatically in the aftermath of the recession in the early 1980's. Steadman, *Disgruntled Borrowers Battle to Break the Bank*, BANKER'S MONTHLY, at 67 (July 1988). In a study performed by the INSIDE LITIGATION newsletter, six of the ten highest civil damage awards in the United States in 1987 came in lender liability cases,

articles, press accounts and seminars have been devoted to the proceedings. The court of appeals' decision has been hailed by lenders as signalling the judiciary's return to a method of legal analysis emphasizing specific loan provisions, such as commitment "expiration" dates, while discounting the significance of the parties' conduct.[7]

The wide attention given to this case also reflects the fact that, aside from this Court, the Second Circuit is the most influential court in the nation with respect to com-

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with the *Penthouse* award at the top of the list. *Lender Liability Cases Dominate 1987's List of Largest Verdicts*, 1 INSIDE LITIGATION 9 (May 1988). As the Wall Street Journal commented, the *Penthouse* decision is a "sweeping ruling that will help shield lenders from borrower lawsuits," and will have broad impact "[b]ecause there have been few appellate decisions to guide trial courts in this relatively new area of law, and because Second Circuit rulings are influential in business matters . . . ." Wall St. J., Aug. 29, 1988, at 2.

[7] For example, one commentator observed that the Second Circuit's decision "has, perhaps, signaled a new judicial approach to the law of lender liability" by emphasizing "the formal, written agreements of the parties . . . over the informal oral communications." T. Boudreau, *The Penthouse Reversal*, 2 LENDER LIABILITY REP. 1, 3 (Nov. 1988). The Chairman of the Commercial Finances Services Committee of the American Bar Association's Section of Corporations, Banking and Business Law, similarly commented that the trial court's failure to give sufficient weight to the written loan documents "threatened the very fabric of the lending process." Chicago Trib., Sept. 4, 1988, at 1, 4. Numerous commentators have offered advice on restructuring commercial loan practices to both borrowers and lenders in the wake of these decisions. *See, e.g.*, Chaitman, *Brakes Applied on Lender Liability Claims*, N.J. Law Journal, 7, 19 (Nov. 3, 1988). Other commentators have found aspects of the court of appeals' decision seriously flawed and likely to chill prosecution of lender liability claims by both large and small borrowers. *Second Circuit Throws Out $128 Million Judgment In Penthouse Suit Against S&L*, 51 BANKING REPORT (BNA) 447, 448 (Sept. 12, 1988).

mercial matters. Syndicated loans, like the one involved in this case, are rapidly becoming commonplace and involve the combined resources of many financial institutions. The duties and responsibilities of lenders *inter se* and to their borrowers in these often enormous financial transactions are of paramount importance.[8] The Federal Home Loan Bank Board recognized as much and saw fit to participate in the appeal as an *amicus curiae*.

In a case of this prominence, the errors committed by the court of appeals should not go uncorrected. The Court therefore should grant the petition, vacate the judgment, and remand to the court of appeals with instructions to remand to the district court for factual findings in light of the governing state law principles. *See Exxon Co., U.S.A.* v. *Banque de Paris et des Pays-Bas*, ___ U.S. ___, 109 S. Ct. 299 (1988) (vacating and remanding for consideration of controlling state law authority); *Dennison Manufacturing Co.* v. *Panduit Corp.*, 475 U.S. 809 (1986) (*per curiam*) (granting *certiorari* and vacating and remanding for explanation of whether the court of appeals had made a factual finding); *Icicle Seafoods, Inc.* v. *Worthington*, 475 U.S. 709 (1986) (vacating and remanding because of improper fact-finding by appellate court).

1. The decision of the court of appeals ultimately rested on three propositions: (1) the parties had set March 1, 1984, as the date when the loan commitment would expire; (2) Dominion's conduct prior to March 1 did not

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[8] *See, e.g.*, Borders, *The Growth of Lender Liability: An Economic Perspective*, 21 GA. L. REV. 723 (1987).

amount to an anticipatory breach; and (3) Penthouse could not have satisfied the closing conditions by that date.[9]

The appellate court's decision fashions a rule of law for commercial transactions completely at odds with the law of the State of New Jersey, which the court had a duty to apply in this case. The holding of the court of appeals is that when the parties set a time limit on the loan commitment and then do not close within that period, the lenders are thereby relieved of any further legal obligations to the borrower. In New Jersey and elsewhere, the law is to the contrary. The legal consequence of the parties' failure to close a loan before a contractual commitment expiration date depends, in the first instance, on whether "time was of the essence."

Under this fundamental and well-established legal doctrine—which the court of appeals completely disregarded —a court must determine whether the parties intended to make "time of the essence" by examining "the relations of the parties, the surrounding circumstances and the objects of the parties." *Selective Builders, Inc.* v. *Hudson City Savings Bank*, 137 N.J. Super. 500, 349 A.2d 564, 566 (N.J. Super. Ct. Ch. Div. 1975).[10] If the parties did

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[9] Thus, the court of appeals held that "the district court erred as a matter of law when it took into account Dominion's post-March 1st conduct when determining the existence of an anticipatory breach." (Pet. App. 32a.) In addition, the court determined that "Penthouse failed to carry its burden at trial to demonstrate that it was ready, willing and able to perform its contractual obligations at any time before March 1st." (Pet. App. 45a.) The court of appeals therefore concluded that the elements of an anticipatory breach had not been established.

[10] *E.g.*, *Hoffman* v. *Perkins*, 3 N.J. Super. 474, 67 A.2d 210, 213 (N.J. Super. Ct. Ch. Div. 1949) ("As a general rule, in equity, time is

not make time of the essence in their contract, New Jersey law treats contractually-set time periods for performance "as formal rather than essential." *Salvatore* v. *Trace*, 109 N.J. Super. 83, 262 A.2d 409, 413 (N.J. Super. Ct. App. Div. 1969), *aff'd per curiam*, 55 N.J. 362, 262 A.2d 385 (1970). If the court finds that time was not of the essence, the parties' obligations do not automatically expire on the date set in the contract but continue for a "reasonable" period of time. *Selective Builders, Inc.* v. *Hudson City Savings Bank, supra*, 349 A.2d at 568; *Salvatore* v. *Trace, supra*, 262 A.2d at 413.[11]

Here, the court of appeals did not even seek to determine whether, under New Jersey law, time was of the essence. Although *Selective Builders* was cited to it,[12] the court of appeals did not discuss the intention of the parties in this regard and it failed to take into account any of the circumstances surrounding this transaction. All that appears in the opinion is a finding that the parties "agreed" to a March 1 closing date, and therefore the loan commitment must have expired at the same time. But what importance the parties placed on the March 1 date

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not deemed to be of the essence of a contract unless so made by express stipulation or unless the parties have so treated it that it necessarily follows from the nature and circumstances of the contract"); *Diamonde* v. *Berkeley Twp.*, 142 N.J. Eq. 140, 59 A.2d 617 (N.J. Ch. 1948).

[11] While *Salvatore* and *Selective Builders* involved equitable actions for specific performance, New Jersey law has evolved so that time is not ordinarily of the essence in contract actions at law seeking damages. *Richmond* v. *Biggans*, 821 F.2d 959, 962 (3d Cir. 1987) (diversity suit applying New Jersey law). *See Hodes* v. *Dunsky*, 5 N.J. Super. 333, 69 A.2d 34, 36 (N.J. Super. Ct. App. Div. 1949) (noting "strong tendency to depart from a strict enforcement" of the time-of-the-essence rule in actions at law.).

[12] Brief for Plaintiffs-Appellees, at 54, 56, 57, 64 (Feb. 15, 1988).

was a *question of fact* that, as we discuss at pp. 20-24 *infra*, should have been decided initially by the district court on remand.

Even if "time" had been "of the essence" with respect to this agreement, the court of appeals again ignored controlling New Jersey law when it concluded that "the parties' conduct in continuing to negotiate after March 1st," although "consistent with an implied extension of the expiration date," could not extend the parties' obligations because that would be "inconsistent with [the loan commitment's] clear language." (Pet. App. 30a.) The rule of law embodied in that holding flatly contradicts the well-settled doctrine of New Jersey law that parties, by their conduct, may waive or extend contractual expiration dates. Lenders are thus not necessarily relieved of their obligations merely because a firm loan commitment date has passed.

For example, in *Selective Builders, Inc.* v. *Hudson City Savings Bank*, *supra*, 349 A.2d at 568, the court held that the conduct of the parties—not the written instrument—is determinative under New Jersey law, even when the parties' written agreement provided that the loan commitment would "automatically expire" on a certain date. Through their actions, the parties may in effect waive an expiration date despite a contractual provision requiring extensions to be agreed upon in writing. *Salvatore* v. *Trace*, *supra*, 262 A.2d at 413.[13] New Jersey thus follows

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[13] *E.g.*, *Koolvent Aluminum Awning Co.* v. *Sperling*, 16 N.J. Super. 444, 84 A.2d 762, 763 (N.J. Super. Ct. App. Div. 1951) ("the initial effectiveness of a contractual provision declaring time to be of the essence may be subsequently waived, and the intention to annul it may be disclosed by the conduct of the parties"); *Hoffman* v. *Perkins*, *supra*, 67 A.2d at 214 (an express provision making time of the essence "may be subsequently waived by the parties either by an

the general principles set forth by Professor Williston in his treatise, which the court in *Salvatore* (262 A.2d at 413) quoted with approval:

> When a specific time is fixed for the performance of a contract and is of the essence of the contract and it is not performed by that time, but the parties proceed with the performance of it after that time, the right to suddenly insist upon a forfeiture for failure to perform within the specified time will be deemed to have been waived and the time for performance will be deemed to have been extended for a reasonable time.

6 Williston, A TREATISE ON THE LAW OF CONTRACTS § 856, at 232 (3d ed. 1962).[14]

Here the court of appeals became so absorbed in making factual inquiries for the first time on appeal that it completely neglected its duty to apply these legal principles. The court devoted its attention to a question of fact —what date did the parties set for expiration of the loan commitment?—and once having provided the answer of March 1, 1984, gave that date a determinative significance that New Jersey law does not recognize. When the court of appeals acknowledged that the parties' conduct after March 1 was "consistent with an implied extension of the expiration date," and then held that the commitment nev-

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affirmative declaratory act to that effect or by their conduct"); *Hudson City Sav. Bank* v. *Brockhurst*, 138 N.J. Eq. 582, 49 A.2d 436, 437 (N.J. Ch. 1946) (a contractual provision declaring time of the essence "may be waived and the intent to annul it may be disclosed by the conduct of the parties").

[14] This is also the rule in the other states within the Second Circuit. *See, e.g., Oleg Cassini, Inc.* v. *Couture Coordinates, Inc.*, 297 F. Supp. 821, 830-31 (S.D.N.Y. 1969); *Grenier* v. *Compratt Constr. Co.*, 189 Conn. 144, 454 A.2d 1289, 1293 (1983).

ertheless expired on March 1 because courts are "not at liberty to construe that agreement in a manner inconsistent with its clear language," the court of appeals promulgated a legal doctrine flatly inconsistent with New Jersey law.

Moreover, by viewing closing dates and commitment expiration dates as rigid and immutable timetables in syndicated loan transactions, the court of appeals also demonstrated its lack of familiarity with established commercial custom and practice. The record here shows that such dates are generally considered flexible; the actions of the parties were fully consistent with that view. Indeed, Dominion's expert witness testified that the "closing date, unless somebody has to raise money in the Eurodollar market it doesn't really mean a lot" and that "nobody really gives a damn" if the commitment date set in the contract expires "as long as we're working towards the closing" (J.A. 1323). The district court elicited this testimony and expressed agreement with it *(id.)*.

To the court of appeals, however, the written instrument rather than the conduct of the parties will control. New Jersey law, as we have discussed, is to the contrary.[15] The Court has quite recently exercised its supervisory authority to correct such departures from the appellate courts' duty under *Erie* to apply substantive state law in diversity suits. *Exxon Co., U.S.A.* v. *Banque de Paris et des Pays-Bas*, 828 F.2d 1127 (5th Cir. 1987),

[15] Had it applied the proper legal standards, the court of appeals could not have dismissed as irrelevant Dominion's and Gorelick's conduct after March 1, 1984, and it would have been apparent that the district court's consideration of that conduct in finding an anticipatory breach was entirely proper and consistent with the governing state law.

vacated and remanded, ___ U.S. ___, 109 S. Ct. 299 (1988). It should do so here.

2. The court of appeals not only failed to apply state law, but also improperly relied on "facts" that it found on appeal. Yet fact-finding in our federal judicial system "'is the basic responsibility of district courts,'"[16] and this Court has forcefully admonished the federal appellate courts not to intrude into the area.[17]

As we have indicated, the decision of the court of appeals rested on the proposition that the loan commitment expired on March 1, 1984, because that was the last date for closing the loan. (Pet. App. 28a.) According to the court of appeals, "Penthouse and Queen City agreed that the closing date would be 'no later than' March 1st." (Pet. App. 29a.) What evidence was there of such an agreement? The district court had made no findings of fact to this effect and there is no document signed by the parties expressly manifesting such an agreement.[18] Instead of a

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[16] *Pullman-Standard* v. *Swint*, 456 U.S. 273, 291 (1982) (*quoting DeMarco* v. *United States*, 415 U.S. 449, 450 n. (1974)).

[17] In *Icicle Seafoods, Inc.* v. *Worthington*, 475 U.S. 709 (1986), the Court reversed the court of appeals because it improperly "made factual findings on its own" even though, as Justice Stevens noted in dissent, the findings related to "undisputed facts." 475 U.S. at 714, 715. Similarly, in *Dennison Mfg. Co.* v. *Panduit Corp.*, 475 U.S. 809 (1986) *(per curiam)*, the Court granted certiorari and remanded the case to the court of appeals for an explanation of the standard of review it applied and the degree to which its decision on a key point was "one of fact." 475 U.S. at 811.

[18] The court of appeals stated that the district court had implicitly "found that March 1 was the date set for *closing*." (Pet. App. 29a) (emphasis added). Whether the district court considered this merely a projected closing date, as the trial testimony indicated, or a targeted closing date, as Queen City's vice president wrote, the court of appeals did not say. *See* note 19, *infra*.

written agreement, the court of appeals relied on a letter from Queen City's attorney Lipari to Penthouse's attorney, a unilateral letter unsigned by the principals.[19] Perhaps the court of appeals believed that Lipari's letter manifested an agreement reached orally, but the court pointed to no such oral agreement and Lipari himself testified that he intended the March 1 date in his letter to be merely a "projected closing date" (J.A. 860), not as the court of appeals assumed, some immutable deadline.[20]

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[19] The court of appeals' finding that the parties intended their obligations to expire on March 1, 1984, rested entirely on a November 21, 1983, letter from Queen City's outside attorney Lipari to Penthouse's counsel. The letter stated that on the basis of a "cursory review" of the legal services needed and discussions with Penthouse's counsel, "it is agreed that we shall close this loan no earlier than February 1, or later than March 1, 1984." (Pet. App. 101a.) Lipari's letter was unilateral: it was not signed by anyone from Penthouse and did not call for assent. On the same date it was written, Queen City's vice president wrote to Penthouse stating that "[p]ursuant to our arrangements with our participants, we have set February 1, 1984 as the *targeted closing date of this loan.*" (Pet. App. 99a.) (emphasis added). The court of appeals, for reasons that do not appear, ignored this letter and failed to mention Lipari's testimony that March 1 was merely a "projected closing date." (J.A. 860.) Indeed, as late as February 6, 1984, Dominion was telling potential participants that it thought that the loan would close "in February or *March* of 1984." (Pet. App. 108a.) (emphasis added).

The court of appeals never explained how it could find as a factual matter that Lipari's letter constituted an *agreement* between the "parties" that the loan *must* close by March 1, 1984. Instead, the appellate court simply asserted this supposed fact without pausing to assess the scope of its authority to make such a finding. *See* Pet. App. 27a ("The parties . . . agreed [on November 21] that the 'closing date' for the loan would occur 'no earlier than February 1, 1984 or later than March 1, 1984.'").

[20] This is the reason why the district court did not restrict its consideration of the evidence to pre-March events, but found that an

The court of appeals was required to remand the case to the district court for the necessary factual findings concerning what the parties intended with respect to the closing date of the loan, and when the loan commitment expired. When New Jersey law is considered, it is clearer still that a remand was required. Whether time was of the essence, whether Penthouse could have closed within a "reasonable" time after March 1, whether the parties had waived or extended whatever expiration date they had set —these were essentially questions of fact.[21]

If the court of appeals believed, as it apparently did, that the district court had not applied correct legal principles, even this would not have authorized it to assume the role of fact-finder. As the Court held in *Pullman-Standard* v. *Swint*, 456 U.S. 273, 291 (1982), "[w]hen an appellate court discerns that a district court has failed to make a finding because of an erroneous view of the law, the usual rule is that there should be a remand for further proceedings to permit the trial court to make the missing findings

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anticipatory breach occurred *because* of Gorelick's conduct "during February and March 1984." (Pet. App. 87a.) If the district court had considered March 1 to be the cut-off date, it would not have applied the law of *anticipatory* breach; the ultimate legal question would simply have been whether Dominion had breached the agreement by failing to act in good-faith to close the loan on or before March 1.

[21] Where time is not made of the essence in a contract, the time for performance is subject to a "test of reasonableness applied by a trier of fact." *Gorrie* v. *Winters*, 214 N.J. Super. 103, 518 A.2d 515, 517 (N.J. Super. Ct. App. Div. 1986), *certif. denied*, 107 N.J. 114, 526 A.2d 184 (1987). *See generally Borough of W. Caldwell* v. *Borough of Caldwell*, 26 N.J. 9, 138 A.2d 402, 412 (1958) ("What constitutes a 'reasonable time' is usually an implication of fact, and not of law, derivable from the language used by the parties considered in the context of the subject matter and the attendant circumstances, in aid of the apparent intention").

. . . ." *See Icicle Seafoods, Inc., supra,* 475 U.S. at 714; *Inwood Laboratories, Inc.* v. *Ives Laboratories, Inc.*, 456 U.S. 844, 857 n.19 (1982). This rule recognizes that an appellate court should not make "factual findings on its own," *Icicle Seafoods, Inc., supra,* 475 U.S. at 714, or "engage in impermissible appellate fact-finding." *Amadeo* v. *Zant*, ___ U.S. ___, 108 S. Ct. 1771, 1780 (1988). Yet that is precisely what the court of appeals did here. *See Anderson* v. *City of Bessemer City,* 470 U.S. 564, 573 (1985) ("appellate courts must constantly have in mind that their function is not to decide factual issues *de novo*").

It is of no moment that, according to the court of appeals, its March 1 finding was based on its construction of "relatively unambiguous documents." (Pet. App. 30a.) While it is true that the construction of an unambiguous contract is a question of law which a federal appellate court may decide in the first instance, it is also well settled that contract construction *does* involve questions of fact—which must be determined by the district court—when the contract language is not certain and when extrinsic evidence is necessary to determine the intentions of the parties.[22]

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[22] It has been settled since *West* v. *Smith*, 101 U.S. 263, 270 (1879), that if the effect of a written instrument depends "not merely on its construction and meaning, but also upon extrinsic facts and circumstances, the inferences to be drawn from it are inferences of fact and not of law . . . ." *See, e.g., United Truck & Bus Service Co.* v. *Piggot*, 543 F.2d 949, 950 (1st Cir. 1976) (holding that Rule 52(a)'s "clearly erroneous" standard applies where the district court considered extrinsic evidence of the parties' intent in construing contract); *Lodges 743 & 1746, Int'l Ass'n of Machinists & Aerospace Workers* v. *United Aircraft Corp.*, 534 F.2d 422, 433 (2d Cir. 1975), *cert. denied*, 429 U.S. 825 (1976); 9 C. Wright & A. Miller, FEDERAL PRACTICE AND PROCEDURE: CIVIL § 2588, at 751 (1971).

Here, the court of appeals itself acknowledged that the agreement could not be construed according to its exact terms because it "would make no sense" for parties to agree to close a loan after the loan commitment expired. Rather, the agreement had to be read in light of "the parties' conduct" and what they "must have intended" (Pet. App. 28a), and the court of appeals looked to extrinsic evidence concerning communications before and after March 1, 1984, in order to reach its factual conclusions that March 1 was a firm and immutable closing date and loan commitment expiration date (a date after which the parties had no obligations to each other). (Pet. App. 28a-29a.) It is thus apparent that the court of appeals did not treat the documents as unambiguous and the record demonstrates that they were far from even "relatively unambiguous."[23]

3. The court of appeals also used its March 1 finding in measuring Penthouse's ability to satisfy the preclosing conditions. According to the court, Penthouse could have established that it was ready, able and willing to perform by March 1 only if some of the conditions had been waived. But, the court of appeals ruled, the lead lender Queen City did not have the authority to waive any closing conditions in light of its agreements with the other participating lenders.

In so ruling, the court of appeals displayed great confusion about what appellate function it was performing. At first, the court of appeals asserted that the district court "failed to make factual findings or legal conclusions establishing Queen City's authority to waive any preclosing conditions on behalf of Dominion." (Pet. App. 23a.) Later, it took the utterly inconsistent position that the

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[23] *See* note 19, *supra*.

district court had made an "unsubstantiated and erroneous finding that Queen City had the authority to waive various essential preclosing conditions." (Pet. App. 42a.)

The truth of the matter is that, although the district court clearly found that Queen City had waived or modified certain preclosing conditions, it never expressly addressed Queen City's "authority" to waive those conditions on behalf of the other lenders. To the extent that the court of appeals' own legal analysis suggested that this was a critical issue, it was incumbent on it to remand the case for determination of Queen City's waiver "authority." *Pullman-Standard, supra.*[24] Similarly, the court engaged in improper fact-finding by summarily concluding that the "substitute performance" offered by Penthouse and accepted by Queen City, instead of "full compliance" with the closing conditions, constituted a "material change" in the loan commitment that would

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[24] It was particularly improper for the court of appeals to determine this issue on its own without considering whether the loan commitment and participation agreements were "unambiguous" with respect to Queen City's authority. In that regard, the court of appeals overlooked contract language that, if not decisive in Penthouse's favor, at least created a substantial degree of ambiguity. Dominion agreed that "the administration of the Agreement together with all final approvals and decisions shall be rendered by Queen City and its legal counsel in their sole discretion, based upon discussions with Dominion . . . ." (Pet. App. 96a.) Dominion also agreed to accept the terms of the loan commitment, which provided that "the decision of the Lender's counsel as to whether all conditions of the commitment have been met shall be final." (J.A. 92.) The court of appeals relied on language in the participation agreement to the effect that Queen City was merely an "independent contractor" (Pet. App. 8a, 40a), but that language appeared in a provision that applied to the post-closing administration of the loan. (J.A. 1544.)

render the other participants "less secure."[25] (Pet. App. 40a.)

By deciding these factual issues, for the first time on appeal, the court of appeals failed to appreciate another question of state law that had to be confronted before it could dispose of the case. Under New Jersey law, participating banks may be estopped from insisting on full compliance with all of the closing conditions. As the New Jersey court made clear in *Selective Builders*, *supra*, 349 A.2d at 566-67, a lender may be estopped from insisting on satisfaction of a closing condition if its silence causes the borrower to believe that closing on less than full and complete performance of the contract terms might be possible. The court of appeals did not pause to consider whether this New Jersey estoppel principle would apply here, even though such an estoppel is fully consistent with the district court's factual finding—never disputed by the court of appeals—that at the time of Queen City's waiver "no participating bank had sought to become involved in reviewing the Queen City commitment conditions, leaving that solely to the lead lender and its counsel." (Pet. App. 71a.) Once again, the court of appeals erred by deciding factual issues never addressed by the district court and by doing so without regard for the principles of state law it had a duty to apply.

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[25] The substitute arrangements offered by Penthouse were likely acceptable to Queen City precisely because they did not constitute material changes affecting the lending banks' security. For example, Penthouse supplied an engineer's certification (that was subject to the approval of Queen City's architect) instead of an architect's certification of compliance with local, state and federal regulations. (Pet. App. 72a.)

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be granted.

Respectfully submitted.

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Dated: January 1989

APPENDIX

United States Court of Appeals

SECOND CIRCUIT

Nos. 862, 863, Dockets 87-9039, 87-9053

PENTHOUSE INTERNATIONAL, LTD.,
and BOARDWALK PROPERTIES, INC.,
Plaintiffs-Appellees,

v.

DOMINION FEDERAL SAVINGS & LOAN ASSOCIATION,
and MELROD, REDMAN & GARTLAN, P.C.,
Defendants-Appellants.

DOMINION FEDERAL SAVINGS & LOAN ASSOCIATION,
Third-party Plaintiff-Appellant,

v.

QUEEN CITY SAVINGS & LOAN ASSOCIATION,
Third-party Defendant-Appellee.

Argued March 7, 1988.

Decided Aug. 26, 1988.

ALTIMARI, Circuit Judge:

Defendants-appellants Dominion Federal Savings & Loan Association ("Dominion") and Melrod, Redman & Gartlan, P.C. ("Melrod" or the "Melrod firm") appeal from judgments entered in favor of plaintiffs-appellees Penthouse International, Ltd. and its wholly-owned subsidi-

ary, Boardwalk Properties, Inc. (hereafter referred to as "Penthouse"), and third-party defendant-appellee Queen City Savings & Loan Association ("Queen City"). After a three-week bench trial in the United States District Court for the Southern District of New York (Judge Kevin T. Duffy), the district court held that Dominion committed an anticipatory breach of its agreement to participate in a $97 million loan transaction. The district court awarded Penthouse approximately $128.7 million and awarded Queen City nearly $7.7 million (plus interest and costs) for the damages caused by Dominion's anticipatory breach. In addition, the court dismissed with prejudice Dominion's cross-claim against Queen City. After the court issued its opinion, it ordered that the Melrod firm be held jointly and severally liable for the Penthouse judgment, not on breach of contract grounds, but for fraud.

Dominion and the Melrod firm present several arguments on appeal. Dominion's principal contention is that the district court erred when it found that Penthouse carried its burden of demonstrating the existence of an anticipatory breach and that, in absence of the breach, Penthouse had the ability to perform its contractual obligations before the loan commitment expired. The Melrod firm argues that there is no basis in law or fact for holding it liable for the Penthouse judgment.

For the reasons that follow, we reverse in part, affirm in part and remand.

FACTS AND BACKGROUND

Sometime after gambling was legalized in Atlantic City, New Jersey, Penthouse's President, Robert Guccione, conceived the idea of opening a Penthouse Hotel and Casino along Atlantic City's famed Boardwalk. To implement this idea, Guccione set about to locate prospec-

tive financiers and potential partners to assist in underwriting the construction project. Boardwalk Properties, Inc. was formed as a wholly-owned subsidiary of Penthouse for the purpose of handling Penthouse's affairs in connection with the hotel and casino project.

Initially unsuccessful in its efforts to obtain outside financing, Penthouse used its own resources to commence the project. Penthouse proceeded to assemble five contiguous plots of land along Missouri Avenue adjacent to the Boardwalk. Three of these parcels Penthouse held in fee simple and the other two were obtained through leasehold estates. The first leased property, on which was located a Holiday Inn Hotel, was obtained from the Boardwalk and Missouri Corporation, an entity controlled by New York real estate financier Harry Helmsley (the "Helmsley lease"). The second leasehold estate, which was then occupied by a Four Seasons Hotel, was obtained from Albert and Robert Rothenburg (the "Rothenburg lease").

Penthouse's construction plans included the use of the existing tower structure from the Holiday Inn, the rebuilding of the structure from the Four Seasons into a second tower and the construction of a seven-story building between the two towers. In these structures, Penthouse planned to house its casino, a 515 room hotel, a health club and other facilities. By June 1983, Penthouse had invested between $65 and $75 million into construction of the hotel and casino which was approximately 40 to 50 percent complete.

Although Guccione believed that the entire project could be financed with Penthouse's own funds when construction commenced, as time passed and costs escalated, it became apparent that it would be necessary to obtain

outside financing. Penthouse then sought financing unsuccessfully from various sources. In or about April 1983, Penthouse retained Jefferson National Mortgage, a mortgage broker, to locate prospective lending institutions interested in providing Penthouse with construction and permanent financing for the hotel and casino project. As a result of Jefferson National's efforts, Queen City extended to Penthouse in June 1983 a $97 million loan commitment.

On June 20, 1983 Queen City issued to Penthouse (through Boardwalk Properties, Inc.) a commitment to lend Penthouse $97 million for construction and permanent financing in connection with the Penthouse Hotel and Casino project (the "Queen City loan commitment" or the "loan commitment"). The Queen City loan commitment was accepted by Penthouse on June 29, 1983. In the loan commitment, Queen City advised Penthouse that "your request for construction/permanent financing . . . with Queen City Savings and Loan Association . . . has been approved subject to the following terms and conditions[.]" The term of the loan was ten years with a construction phase in effect during either the first 24 months or until Penthouse received a certificate of occupancy from Atlantic City and permission to operate the casino. The interest rate was fixed at 14⅞% for years one through five and 15⅜% for years six through ten.

To secure the loan, pursuant to paragraph 6 of the loan commitment, Penthouse was required to deliver to Queen City a mortgage on the hotel and casino and the underlying properties. Thus, Penthouse was required to deliver a note secured by a "valid first mortgage lien on all real estate owned by [b]orrower covering the project site" and all improvements thereon and was required to provide a "valid first lease-hold interest" in the Rothenburg and

Helmsley leases and "a first mortgage covering the improvements thereon." Penthouse also was required to provide assignments of its interest in the leasehold estates to be effective in the event of Penthouse's default. Paragraph 6 required Penthouse to certify at closing that there were "no violations" of the Helmsley or Rothenburg leases.

Paragraph 14 of the loan commitment required Penthouse to represent and warrant 1) that there was no pending litigation that would affect title to the properties, the validity of the mortgage liens, the validity and non-violations of the leases, etc., 2) that the final plans and specifications for construction would satisfy and conform with local, state and federal regulations, and 3) that all necessary utilities (i.e., water, electricity, sewer, telephone service and gas) were available to the full needs of the property and that "valid and enforceable agreements to supply such services have been entered into[.]"

Under the heading of "Commitment Expiration Date," paragraph 15 provided that the commitment would

> expire one hundred twenty (120) days after the date hereof (the "Commitment Expiration Date") unless mutually extended in writing by Lender, and upon such expiration Lender shall have no further obligation to Borrower, except as set forth in item 19 of the attached Conditions.

Paragraph 16 of the commitment, which was headed by the term "Closing", stipulated that the "[c]losing of the Loan ("Closing") shall be held . . . on or before the Commitment Expiration Date[.]"

Paragraph 17 of the loan commitment provided that an additional twenty enumerated "Conditions Prior to Closing" ("preclosing conditions") contained in a document

attached to the commitment were incorporated as part of the commitment. Paragraph 17 also stipulated that "[l]ender's obligation to close the Loan [was] contingent upon the satisfaction of each of said conditions."

In relevant part, the preclosing conditions provided:

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5. TITLE INSURANCE: There shall be furnished to Lender, at least 15 days prior to Closing, a current preliminary title insurance binder, issued by a title company initially approved by Lender. At Closing, a standard ALTA title policy shall be issued by such company insuring Lender's interest or lien in or on the Property subject only to such title objections as Lender shall approve. Such title insurance policy shall affirmatively insure the priority of the lien of the Mortgage. The title company insuring Lender's lien shall obtain re-insurance in such amounts and with such companies, as Lender may require.

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10. UTILITIES: The Lender shall be furnished with copies of all agreements for providing the utility services required for the operation of the Property, including without limitation thereto, agreements pertaining to water, sewer, and electricity and/or original current letters from the suppliers of such utilities stating that the utilities are available and are offered in sufficient quantities for the project.

11. PLANS AND SPECIFICATIONS: The written approval of all plans and specifications for the Improvements to be erected must be obtained from Lender. No change of any substance shall be made in the final plans and specifications without the prior written approval of Lender and all governmental authorities having jurisdiction.

12. CERTIFICATION BY ARCHITECT AND CONSTRUCTION MANAGER: Borrower shall deliver to Lender at Closing a certification by Borrower's architect and construction manager containing (i) a detailed listing of the then-current plans and specifications for the Improvements; (ii) a statement that said plans and specifications are complete documents for the construction of the Improvements and contain all details requisite for the completion, occupancy and operation thereof; and, (iii) a statement that said plans and specifications are in full compliance with all local, state and federal (if any) rules, ordinances and regulations governing or applying to the construction of the Improvements.

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16. CONSTRUCTION—CONTRACTS: Borrower shall submit, for Lender's approval, Borrower's contract with its architect, construction project manager and all major trade contractors. Lender may at its option require assignment of the aforesaid contracts or any of them.

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19. PARTICIPATION: Lender's obligation to complete the Closing is also contingent upon execution of a participation agreement between Lender and other lenders pursuant to which said other lenders will participate in making the Loan (through the Lender as "lead institution") at least to the extent of $90,000,000.00 on terms and conditions satisfactory to the Lender. Borrower acknowledges that it is Borrower's sole responsibility (either directly or through mortgage brokerage companies) to obtain such participants who are satisfactory to Lender, it being understood that Lender shall have no obligation to obtain such participants. In the event the aforesaid $90,000,000.00 participation agreements are not obtained, then Lender shall refund to Borrower the origination fees it received pursuant to Item 8 of the

Commitment.

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The preclosing conditions also established that New Jersey law would govern the terms of the loan commitment and stipulated that Queen City's attorneys would have the final decision on whether the various preclosing conditions had been satisfied. Nowhere, however, did the commitment or the preclosing conditions provide that Queen City was authorized by the participating lending institutions to waive Penthouse's compliance with any of the terms of the commitment.

Once the loan commitment was in place, pursuant to preclosing condition 19, Queen City and Penthouse began searching for financial institutions interested in participating in a syndicate of lenders to underwrite the loan. Lending institutions that decided to participate in the syndicate (the "participants") would enter into a "Loan Participation Sale and Trust Agreement" (the "participation agreement"). Under the commitment, Queen City was designated to serve as the lead lending institution (the "lead lender") for the syndicate. Under the participation agreement, the participants would purchase from Queen City "undivided participating ownership" interests in the mortgage loan. Pursuant to the participation agreement, Queen City assumed various administrative responsibilities for servicing the loan. The agreement stipulated, however, that Queen City was to act, not as an agent, but as an "independent contractor" for the participants and would serve "as a trustee with fiduciary duties" in connection with protecting the rights of the participating lenders. In addition, the participation agreement contained an integration clause, provided that it could not be modified except by written agreement and established New Jersey law as the governing law.

By the fall of 1983, twelve financial institutions, including Queen City, had agreed to participate in the financing syndicate and had committed to provide a total of $62 million for the project. In mid-November 1983, Dominion expressed interest in providing Penthouse with financing and on November 14th offered directly to Penthouse a commitment to provide $40 million in financing for the project. Although Dominion's offer was never accepted, it did lead to Dominion's decision on November 21, 1983 to participate in the $97 million loan syndicate.

On November 21, 1983, a meeting was held at Penthouse's offices in New York City. In attendance at the meeting were representatives of Penthouse, including its Chief Operating Officer and General Counsel, David J. Myerson, and Penthouse's outside counsel for the loan transaction, Jay Newman; representatives of Queen City, including its Senior Vice President, John E. Beahan, and Queen City's attorney, John J. Lipari; and representatives of Dominion, including its Executive Vice President, David A. Neal, and its outside counsel, William J. Dorn. At this meeting, Dominion agreed to participate in the loan syndicate to the extent of $35 million. Dominion's agreement to participate in the loan was embodied in three documents: two letter agreements exchanged between Queen City and Dominion and a third document which was a letter from Penthouse to Dominion. In substance, Dominion "accepted" all of the terms and conditions of both the loan commitment and the participation agreement except that the participation agreement was amended to include Dominion as "co-lead seller" for the syndicate. In addition, the loan commitment was modified at the meeting in a side agreement between Penthouse and Queen City to include as a preclosing condition that "arrangements, reasonably satisfactory to [Queen City],

shall have been made with the staff o[f] the Casino Control Commission to permit the opening of the casino and hotel, upon completion of construction, utilizing a trustee or fiduciary in the event the license to [Penthouse] . . . or any of its principals has not been granted."

Although it does not appear that Dominion entered into any written agreement with Penthouse directly, Penthouse did deliver to Dominion a letter indicating that it agreed to pay Dominion certain fees "[i]n consideration" for Dominion's agreement to participate "as a Co-Seller" for the syndicate. Penthouse also gave Dominion a check for $175,000 for fees it agreed to pay.

Also on November 21st, Penthouse and Queen City mutually agreed to extend the Commitment Expiration Date to December 1, 1983. This written extension was prompted by Lipari's observation that the 120-day condition of the commitment had expired and his belief that, in order to have a "valid commitment," it was necessary for Queen City and Penthouse to mutually extend the expiration date. In addition, Lipari discussed the timing of the loan closing with Newman and Dorn, and then, in a letter also dated November 21st, Lipari and Newman agreed that "we shall close th[e] loan no earlier than February 1, 1984 or later than March 1, 1984."

Once the loan commitment syndicate was complete, Penthouse and Queen City directed their efforts to closing the transaction. Toward that goal, Lipari and Newman maintained regular contact and Lipari held a series of "status meetings" during which representatives of Penthouse and Queen City reviewed the steps taken in connection with Penthouse's satisfaction of the preclosing conditions. During these status meetings, Penthouse sought alternative arrangements for satisfying some of

the preclosing conditions. For example, although preclosing condition 10 required Penthouse to deliver copies of all agreements for providing utility services required for the operation of the hotel and casino and/or original, current letters indicating that the utilities would be available in sufficient quantities for the project, Penthouse sought to proceed without having fully satisfied this condition. Penthouse did not have agreements with some utility companies to provide certain essential services and it did not have written assurances that those services were available to meet the demands of the proposed hotel and casino. Similarly, Penthouse sought to proceed to closing without having fully complied with preclosing conditions 11, 12 and 16.

Penthouse's position in this regard was that, since the construction project was 40 to 50 percent complete, many of the requirements of the preclosing conditions could be satisfied through substitute arrangements. Thus, instead of providing an architect's and construction manager's certificate, as required by preclosing condition 12, Penthouse offered to provide a certificate from its project engineer and to allow Queen City's architect to examine the project. This substitute performance was necessary because, at that time, Penthouse had not retained an architect. In place of providing Queen City with copies of final plans and specifications for the project, as required by the preclosing conditions, Penthouse sought to provide Queen City with its original plans and specifications for the project, even though they were out of date due to changes in the applicable building codes and despite the fact that Penthouse had no final plans for the electrical or mechanical work on the project. Notwithstanding the modifications Penthouse sought, Lipari was satisfied that the transaction could close in light of Penthouse's prof

fered substitute performance. It does not appear, however, that Lipari sought Dominion's or the other participants' consent to a waiver of Penthouse's full compliance with any preclosing conditions.

After the second status meeting, Queen City sent Dominion and the other participants a letter stating in essence that substantial progress had been made toward satisfying the preclosing conditions and announcing that a "preclosing meeting" would occur sometime between February 1 and 8, 1984. It was later determined that the "preclosing meeting" would occur on February 9, 1984 at Penthouse's New York offices.

Once Dominion agreed to participate in the loan syndicate, it proceeded to attempt to sell in the secondary market sub-participation interests of its $35 million interest in the loan syndicate. Dominion's decision to subparticipate out its interest in the loan was motivated in part by the fact that its legal lending limit was $18.5 million. Thus, Dominion could not lend to a single borrower more than that amount. By letter agreement dated December 2, 1983, Dominion sold to Community Savings & Loan Association ("Community") a $17.5 million interest in its original $35 million participation interest. At that time, Community had not completed its underwriting analysis of the loan, and proceeded with this analysis in December 1983 and continued on through February 1984. In early February 1984, however, Community started to show some reticence with proceeding in the transaction.

As Penthouse and Queen City prepared for the "preclosing meeting" set for February 9, 1984, Newman received a letter from Commonwealth Land Title Insurance Company regarding Penthouse's ability to furnish

the mortgage security required by the loan commitment. This letter indicated that there were several objections to title on the Helmsley lease. That parcel was subject to two mortgages, the McShane mortgage and the Chase mortgage, which needed to be discharged or subordinated before Penthouse could furnish the required security. Unless the McShane and Chase mortgages were discharged or subordinated, if foreclosed upon, they potentially could wipe out the Helmsley lease and any security interest in that lease. The letter also raised title objections to the Rothenburg lease and pointed out that there was a declaration of encumbrances in connection with the parcels held in fee simple which had to be removed or modified. In addition to the title problems, it also appears that the Helmsley lease had to be modified before closing. Unless the lease was modified, the closing of the loan would violate its terms. The commitment required, however, that Penthouse certify, at closing, that there were "no violations" of that lease.

To resolve the various title problems and the problems with the terms of the lease, Newman knew that he would have to negotiate a discharge or subordination of the McShane and Chase mortgages, negotiate with Helmsley to obtain amendments to the lease and obtain a subordination of encumbrances in connection with the Helmsley leased property. Although Penthouse had made some initial contacts with Helmsley's representatives by February 9th, no agreement resolving these problems had been reached, nor had actual negotiations with Helmsley's representatives commenced. It is also unclear whether the holders of the Chase and McShane mortgages were willing to discharge or subordinate their liens because they apparently had not been contacted by February 9th.

On February 9, 1984, representatives of the parties to the loan transaction and the participants met at Pent-

house's offices in New York City for the preclosing meeting. Among several others, Lipari was present to represent Queen City and Newman was there representing Penthouse. Penthouse's Myerson made sporadic appearances throughout the meeting. Dominion was represented by Philip Gorelick of the Melrod firm who had been brought into the deal on February 8th. At the meeting, after Penthouse made a presentation of a scale model of the planned hotel and casino, Lipari handed out some press clippings, copies of status reports and copies of draft loan closing documents. He then reviewed each of the preclosing conditions and described the progress made toward their satisfaction. Among the draft closing documents Lipari circulated was a standard, preprinted, six-page "Blumberg" form for a "plain language" mortgage and a standard, six-page, preprinted form for a "security agreement" for the furniture and fixtures. At the top of the Blumberg form appeared the admonition: "Consult your lawyer before signing this mortgage—it has important legal consequences." The draft mortgage included a rider requiring that Penthouse satisfy each of the preclosing conditions. Nowhere in the draft closing documents was there a provision allowing for preclosing conditions to be waived or modified.

After sitting through the meeting and reviewing the documents prepared by Lipari, Gorelick presented a list of items he wanted to review prior to deciding whether Dominion could proceed. He also indicated his belief that the loan transaction was not in a position to close, explaining that, in light of the unresolved title problems, problems with the leases, the unfulfilled status of some of the preclosing conditions and inadequacy of the draft loan documents, he would not advise his client to proceed.

Gorelick gave the strong impression that the entire deal had to be overhauled. In giving this impression, Gorelick

was less than tactful. He was particularly vehement about the inadequacy of the documents prepared by Lipari, which he described as "idiotic." To satisfy Gorelick's concerns, Queen City and Penthouse agreed to allow Gorelick and his firm to prepare appropriate closing documents and to review condition compliance in order to bring the deal to a close. Penthouse also agreed to pay the Melrod firm's fees while it focused its resources on the loan transaction.

After Penthouse and Queen City gave Gorelick and the Melrod firm responsibility for moving the deal toward closing, Gorelick immediately sought documents and information from Penthouse concerning all aspects of the transaction. Gorelick then drafted checklists of the documents and information he felt was necessary to review and communicated these checklists to Newman. Gorelick's checklists were very broad in scope and covered all facets of the hotel and casino project. Gorelick's initial requests for information regarding the transaction were communicated on February 9th, but were followed up by several additional requests later that month. Newman responded at length to these requests in letters dated February 29th and March 1st 1984.

Responsive to the problems with the Helmsley lease, Melrod lawyers prepared a list of proposed amendments to the Helmsley lease that they believed were necessary before closing. Gorelick insisted that Penthouse seek the proposed amendments from Helmsley and described each amendment as being "required." When, however, the proposed amendments were sent to Penthouse, they were accompanied by a cover letter from Gorelick's partner, Louis Trotter, that indicated that the proposed amendments reflected "a nearly final version of what the lender

will be looking for and [would] certainly provide you with a jumping off point for your discussions with Helmsley."

To respond to an inquiry concerning the status of alternate licensing arrangements, which was required as a preclosing condition, Penthouse's attorney, Arthur S. Goldstein, sent the Melrod firm two letters. These letters addressed the status of Penthouse's license application and set forth the results of Goldstein's inquiries with the staff of the New Jersey Casino Control Commission ("CCC"). In the first letter, after providing an overview of the New Jersey Casino Control Act (the "act") and explaining in detail the license application process, Goldstein discussed the status of Penthouse's application. He stated that Penthouse had commenced the application process but that, at its request, the process had been suspended in September 1982 pending the outcome of Penthouse's efforts to obtain financing. As of February 1984, the application process had not been reactivated. Goldstein also explained that the financial institutions participating in the loan transaction would have to "qualify" under the act. Goldstein's prognosis as to the timing of licensing was that the whole process might be accomplished within a year.

More directly responsive to the status of the preclosing condition was Goldstein's second letter. The preclosing condition required that "reasonably satisfactory" arrangements be made with the staff of the CCC to permit the opening of the casino in the event that Penthouse did not obtain a license. In the second letter, Goldstein stated that he had discussed the matter with staff members at the CCC, but he explained that they had no authority to make binding decisions and that it would be necessary for Penthouse to submit a formal proposal. Nevertheless, based upon his informal discussions with

the CCC staff, Goldstein opined that if Penthouse became unlicenseable, it would be necessary for it to completely divest itself of any "beneficial interest" in the casino. He suggested that this could be accomplished by using a trustee who would buy out Penthouse's interest in the casino. He also stated that this transaction would have to be structured in such a manner to insure that Penthouse would have no recourse against the casino in the event of default. After Goldstein set forth additional details of the proposed trusteeship and the buy-out transaction, he concluded by stating that his comments only reflected a "rough outline of what I believe to be a proposal that might be acceptable to the Commission."

In addition to the document and information exchanges, Gorelick and representatives of Dominion engaged in a series of meetings with Myerson and, subsequently, Guccione. At one meeting held on February 29, 1984, Myerson met with Gorelick and other Melrod attorneys to discuss the progress toward closing. Gorelick indicated that he was still in the process of revising his closing checklists and that until he had finished that analysis there was not much to discuss. At that meeting or shortly thereafter, Gorelick reminded Myerson that, since the loan commitment would expire on March 1, 1984, Myerson should submit a request for an extension of the commitment expiration date. Myerson refused, however, to make such a request. Myerson believed that the loan commitment could not expire unless and until Penthouse was presented with the closing documents.

Later in the day on February 29th, Myerson went to Dominion's offices in McLean, Virginia where he met with Dominion's President, David Neal, and a representative of Community, William J. Wienke, Jr. Neal explained that Wienke was present at the meeting because Community

was a participant in the loan. During the course of the meeting, the parties discussed various aspects of the project. At the conclusion, however, Wienke expressed his concern about the delays in closing and told Myerson that he needed more information about the loan. Wienke then presented Myerson with a list of thirty-five items concerning the transaction and explained that "this is the kind of stuff that I need." Myerson said that he would review the matters raised in Wienke's list.

Also on February 29th, Gorelick, Wienke and Neal engaged in a telephone conference call to discuss the transaction. During this telephone conference, Wienke explained that he was "getting a bad feeling" about the transaction and inquired whether the commitment should be terminated due to Penthouse's failure to satisfy the preclosing conditions by the March 1st date. Gorelick advised against this and Wienke acquiesced.

In addition to Gorelick's work on the transaction, representatives of Dominion were sending information requests and other items to Penthouse directly. For example, on March 1, 1984, Dominion's Vice-President, James Winston Bray, sent Myerson a letter recapping the "areas of concern" which he felt "need[ed] particular attention." Bray stated that one matter he thought needed addressing—"to make the proposed financing for the project marketable"—was the existence of "[a] satisfactory management agreement, prior to loan closing, for the operation of the proposed hotel." Nevertheless, he prefaced his comments by stating that his concerns were not intended "to replace or diminish" the various other aspects of the loan transaction.

On March 6, 1984, Myerson met with Guccione and Dominion's Chairman of the Board, William L. Walde, at

Guccione's home. Although Walde expressed Dominion's continued interest in financing the project, he raised concerns regarding Queen City's ability to serve as the lead lender for the transaction. Walde described Queen City as a small and inconsequential savings and loan and suggested that it was ill-equipped to handle a transaction of this size. Guccione said that he would speak to Queen City about Walde's concerns, but he also stated that he thought it would be unfair to remove Queen City from the lead position.

On March 14, 1984, Guccione flew to Washington, D.C. to meet with Walde. At that meeting, Guccione told Walde that Queen City would not relinquish its lead position, but he offered to compensate Dominion for the fees that it otherwise would have earned had it been the lead lending institution. Also at this meeting, Walde informed Guccione that he wanted to appoint a construction company, Sigal, to perform a long in-depth reevaluation of the structure, the steel and all the parts thereon. Guccione explained that he thought that this was unnecessary. Walde also requested that Penthouse designate a specific individual at Penthouse whose sole responsibility would be to address matters of concern raised by Dominion in connection with the loan transaction.

On March 15, 1984, Walde followed up the meeting with Guccione by sending him a letter summarizing the issues discussed which Guccione had agreed "to look into." One of the items for review was that "[t]he hotel manager [was] to submit to lender a hotel management program." On March 22, 1984, Dominion's Neal sent a letter to Guccione recommending that Penthouse engage Sigal to formulate a construction cost evaluation. Neal concluded the letter by stating that he felt that "this project has been allowed to drift without direction entirely too long. I

sincerely hope that you will implement our recommendations . . . at the earliest possible time, the decision is, of course, entirely yours." Not long after the March 22nd letter, Penthouse broke off communications with Dominion and the Melrod firm and refused to respond to their telephone calls.

Beginning on March 20, 1984, the loan participation syndicate began to unravel. First, on March 20th, Community sent a letter to Dominion stating that it had "elected not to extend its offer to participate" in the loan. Then, on March 28, 1984, another participant, Shadow Lawn Savings & Loan Association, wrote to Queen City and indicated that in view of the fact that the loan commitment "has now expired" and because interest rates had changed, it had to meet with Queen City before it would "reconsider an extension" of its participation interest. In May and June 1984, several other participants sent notices to Queen City indicating their belief that the loan commitment had expired and that they were relieved of their participation commitments. Subsequently, after it was unsuccessful in obtaining alternate financing, Penthouse filed the instant action in June 1984.

PROCEEDINGS IN THE DISTRICT COURT AND ITS DECISION

A brief review of the district court's docket sheet reveals that the instant litigation was hard fought with several discovery battles and other disagreements. The case proceeded to a bench trial on May 11, 1987 before Judge Duffy and concluded on June 1, 1987. A number of witnesses appeared for both sides and the record was supplemented by affidavits of witnesses who did not appear at trial.

Important to Dominion's defense to the anticipatory breach claim was its insistence that Penthouse was not in any position to close the loan by March 1st because it could not have satisfied various terms and preclosing conditions of the commitment by that time. To address this point, Dominion presented the testimony of an expert in real estate construction and permanent financing transactions, John C. Nelson, who was a partner in the New York City law firm of Milbank, Tweed, Hadley & McCloy. After setting forth the factual predicate upon which he based his opinion, Nelson opined that, in light of the various title problems (which were supported by the objections to title asserted by Commonwealth), the lack of agreements with certain utility companies, the absence of final plans and specifications, no final project budget, the lack of contracts with an architect, a major construction contractor and major trade contractors, and no agreement concerning casino licensing, the transaction was in no position to close any time from 60 days to six months from the February 9th preclosing meeting. When Nelson presented his opinion at trial, however, the district court asked him how long it would take to close the transaction if all of the preclosing conditions he had taken into account when formulating his opinion (i.e., final plans and specifications, project budgets, trade contracts, etc.) had been waived. Nelson replied that the deal could close as soon as the papers were drawn up. He qualified his response, however, by insisting that a prudent lender would not waive the various conditions which the hypothetical question assumed were waived.

Also important to Dominion's case was the testimony of Melrod partner, Philip Gorelick. Because of his extensive involvement in the transaction, he was in the best position to present Dominion's perspective concerning the deal.

The district court was not, however, receptive to Gorelick's testimony. After Gorelick had concluded his testimony on direct examination and began responding to questions on cross-examination, Judge Duffy called a morning recess. As the Judge was leaving the courtroom, he requested that the Melrod firm's attorney, Robert L. Tofel, join him in the robing room. When Tofel met Judge Duffy in the robing room, the judge handed him a copy of Volume 377 of the Federal Supplement and requested that Tofel read the first line in *United States* v. *Tramunti*, 377 F.Supp. 1 (S.D.N.Y.1974) (Duffy, J.). That line reads: "John Spurdis is a liar." After reading the sentence to himself, Tofel looked at the judge. Saying nothing, Judge Duffy simply shrugged expressively. Tofel then said in essence that Judge Duffy had misread Gorelick. Tofel explained that Gorelick may have been obnoxious or aggressive but that he was not a liar. Again, Judge Duffy did not respond and simply shrugged.

On July 29, 1987, the district court filed its reported decision in which it held in favor of Penthouse and Queen City and against Dominion. *See* 665 F.Supp. 301 (S.D.N.Y.1987). The district court held that Dominion's conduct during February and March 1984 constituted an anticipatory breach of the loan commitment. The district court began its analysis by reasoning that a party to a contract commits an anticipatory breach when it "indicates its refusal to perform unless entirely new or different conditions are first met[.]" *Id.* at 310 (citations omitted). The district court then found that Dominion's conduct on at least four occasions gave rise to an anticipatory breach. Specifically, the court found that 1) Gorelick's demand that Penthouse obtain amendments to the Helmsley lease, 2) Dominion's insistence that a hotel management agreement be entered into prior to closing,

3) Dominion's insistence that Penthouse hire Sigal to perform a construction cost evaluation, and 4) Dominion's insistence that it replace Queen City as lead lender, taken together, "amounted to an unambiguous refusal to close by Dominion", *id.* at 311, and thus constituted an anticipatory breach.

In response to Dominion's argument that Penthouse was not in a position to satisfy the preclosing conditions before March 1st, the district court found that, by the February 9th preclosing meeting, "all of the conditions precedent had been met, waived, or were in a position to have been met by the date set for closing the loan." *Id.* at 310. The district court specifically found 1) that the title and lease problems were "minor" and could be worked out during the "ongoing" discussions with Helmsley, 2) that Queen City had waived Penthouse's full compliance with preclosing conditions 10, 11, 12, and 16; 3) that Penthouse had satisfied preclosing condition 13, and 4) that arrangements with the Casino Control Commission were "easily within reach." *See id.* at 304-05, 310. The court failed to make factual findings or legal conclusions establishing Queen City's authority to waive any preclosing conditions on behalf of Dominion.

The district court explored Dominion's motive for committing the anticipatory breach and found that "[b]ecause of Community's withdrawal on February 29, . . . Dominion either had to stall the closing until the loan expired and then withdraw from its commitment, or breach its agreement." *Id.* at 310. According to the district court, Gorelick was employed to serve as "Dominion's hatchet man intent on destroying the deal," *id.* at 308, that "Dominion hired Gorelick to bully and intimidate the plaintiffs into delaying the loan until Community could be replaced or[,] failing that, to delay until the Commitment

expired and Dominion was released from its obligation." *Id.* at 307.

The district court also carried forward its earlier, private attack on Gorelick's veracity. In its decision, the district court found that Gorelick committed "outrageous perjury" during trial. *Id.* at 306-07. Making reference to Gorelick's trial testimony, the district court stated

> [t]he decision as to the credibility of witnesses is properly left to the trial judge or to the jury because as finders of fact they are in a position to view the demeanor of the witnesses.
>
> Gorelick took the stand and attempted brazenly to lie to the court. During cross-examination, the crucible of truth, Gorelick continuously shifted uneasily in the chair, sweated like a trapped liar, and the glaze that came over his shifty eyes gave proof to his continuing perjury. His total lack of veracity was shown not only by his demeanor but by the shady practices he seemingly reveled in. He charged needless and exorbitant fees, Joint Exh. 41, for work that was intentionally unproductive. While representing the bank he demanded a $150,000 "bonus" from the borrower if the loan closed, an arrangement Gorelick never disclosed to his bank-client.

Id. at 306 n. 1. Thus, the court made a specific factual finding that Gorelick committed perjury during his trial testimony.

After reaching its decision on the liability issue, the district court considered the damage question. The court first determined that Penthouse was entitled to various out-of-pocket and "carrying" expenses. Then, the court turned to the question of whether Penthouse was entitled to recover the profits it would have made had the construction been completed and the hotel and casino become operational. Applying the rationale of *Perma Research &*

Development v. *Singer Co.*, 542 F.2d 111 (2d Cir. 1976), the court determined that Penthouse's lost future profits over a ten-year period could be properly awarded. Accordingly, the district court held that Penthouse was entitled to recover damages in the amount of $129,904,455, $112,083,583 of which was for the lost future profits.

Also in its decision, the district court concluded that Queen City should prevail on its counterclaim in the third-party action: "Having held that Dominion breached its agreement, I must also find it liable to Queen City for that breach." 665 F.Supp. at 312. In addition, the court concluded that Dominion should lose on its third-party claim against Queen City because "[t]here [was] a total failure of proof that Queen City breached any duty owed to Dominion." *Id.*

After the court issued its opinion, Penthouse submitted its proposed judgment to the district court. In the proposed judgment, Penthouse did not name the Melrod firm as a judgment-debtor for the lost profits award. To correct what it perceived as a discrepancy, the district court *sua sponte* conformed the pleadings to the proof and held that the Melrod firm was jointly and severally liable for the entire Penthouse judgment. The court explained that the Melrod firm was liable for the Penthouse judgment because its conduct amounted to active fraud. The district court did not, however, make any factual findings concerning what acts or omissions allegedly perpetrated by the Melrod firm gave rise to the court's conclusion that it committed fraud. Nor did the court explain how a judgment for lost profits which resulted from an alleged anticipatory breach of a loan commitment could also serve as the basis for a fraud judgment.

After amending its original decision, the district court entered final judgment on October 2, 1987 and awarded

Penthouse $128,682,830.80, held Dominion and the Melrod firm jointly and severally liable for that judgment, awarded Queen City $7,652,352.91 plus interest and dismissed Dominion's claim against Queen City with prejudice. Subsequently, in a memorandum and order dated December 2, 1987, the district court denied the defendants' motion for a new trial. 678 F.Supp. 61.

DISCUSSION

Dominion and the Melrod firm raise several arguments on this appeal. Dominion contends that the district court erred in concluding that its conduct amounted to an anticipatory breach of the loan commitment and that the court erred in concluding that Penthouse was ready, willing and able to perform its obligations under the loan commitment. Dominion also argues that the district court applied an incorrect legal standard when it awarded Penthouse damages for its lost future profits and that the court erred when it dismissed its claim against Queen City. The Melrod firm challenges the judgment entered against it on fraud grounds, arguing, inter alia, that because such a finding was not supported in law or fact, the district court erred in sua sponte holding Melrod jointly and severally liable for the Penthouse judgment.

For the reasons that follow, we reverse the judgments entered in favor of Penthouse and Queen City, affirm the dismissal of Dominion's cross-claim and remand with instructions that judgment be entered in favor of Dominion and the Melrod firm.

I. DOMINION'S APPEAL OF PENTHOUSE JUDGMENT

A. *Preliminary matters.*

At the outset, Dominion argues that the loan commitment expired by its own terms on March 1, 1984 and

contends that, after that date, Dominion, Queen City and the other participating lenders were under "no further obligation" to proceed with the mortgage financing. Dominion therefore suggests that the March 1st date has crucial significance in part because it would constitute the date on or before which the parties would have been required to perform and/or satisfy their obligations under the loan commitment.

At the November 21st meeting, the parties understood that the commitment had expired by its own terms. A written extension of the expiration date was therefore necessary to have a "valid" commitment as of the date Dominion agreed to participate. The parties then mutually extended the expiration date to December 1, 1983, but they simultaneously agreed that the "closing date" for the loan would occur "no earlier than February 1, 1984 or later than March 1, 1984." Aside from these agreements, the parties entered into no other arrangements with respect to further extensions of the expiration date or the closing date.

"An agreement must be construed in the context of the circumstances under which it was entered into and it must be accorded a rational meaning in keeping with the express general purpose." *Tessmar* v. *Grosner*, 23 N.J. 193, 128 A.2d 467, 471 (1957) (citations omitted). While courts must accord an agreement "the most fair and reasonable construction, imputing the least hardship on either of the contracting parties . . . so that neither will have an unfair or unreasonable advantage over the other[,]" *id.* (citations omitted), "[w]here no ambiguity exists in a contract it is the duty of the court, as a matter of law, to interpret the same . . . [and] where the parties have said, by very plain words, what they meant, the court has no duty to perform other than to carry their

meaning into effect." *Korb* v. *Spray Beach Hotel Co.*, 24 N.J.Super. 151, 93 A.2d 578, 580 (1952) (per curiam) (citations omitted). In the guise of construing the terms of an agreement, "court[s] will not make a different or better contract than the parties themselves have seen fit to enter into[.]" *In the Matter of the Community Medical Center*, 623 F.2d 864, 866 (3d Cir.1980) (citing *Washington Construction Co.* v. *Spinella*, 8 N.J. 212, 217-18, 84 A.2d 617, 619 (1951)).

The loan commitment provisions concerning the expiration date and closing date are unambiguous. The loan commitment expired by its own terms 120 days after it was issued on June 20, 1983 unless the parties mutually extended it in writing. After the expiration date passed, the commitment clearly provided that the lender would be under "no further obligation" to fund the loan. It also provided that the closing had to occur on or before the expiration date. The parties' conduct in connection with the written extension to December 1st clearly reflected their belief that the expiration clause was self-executing and that the loan commitment could expire by its own terms.

What we must resolve is whether, when the parties agreed to close the loan "no later than March 1, 1984", they intended on extending the expiration date to March 1st. We believe they did. Reading the expiration date clause together with the clause regarding the closing date leads us to conclude that the parties must have intended to extend the expiration date when they agreed that the closing would occur no later than March 1st. Any other construction of these documents would leave the parties agreeing to close the loan after the commitment had expired which would make no sense.

Some participants clearly believed that when Penthouse and Queen City agreed that the closing date would be "no later than" March 1st, this had the effect of extending the expiration date to that date. Thus, when Community, Shadow Lawn and other participants withdrew their commitments, they all based their decisions upon the fact that the commitment expired on March 1st. In addition, Gorelick and Wienke both believed that the loan commitment expired on that date. Indeed, Gorelick brought the problem of the March 1st expiration to Myerson's attention when he suggested that Myerson obtain an extension of the expiration date. Finally, and most importantly, even Penthouse has acknowledged, albeit indirectly, that the commitment was in effect only until March 1, 1984. Thus, in paragraph 7 of Penthouse's complaint, it alleged as a fact that "[t]he loan commitment was scheduled, by its terms, to remain in effect for 120 days after issuance, and was subsequently extended to March 1, 1984." A necessary inference from this allegation is that Penthouse did not believe that the commitment was extended past March 1st.

The district court did not specifically find that the parties extended the expiration date to March 1st, but it did find that the parties had set March 1st as the closing date. Thus, when the district court was reviewing Penthouse's ability to resolve the title problems, it found "that the entire matter could have been resolved in time to close the deal before March 1, 1984." 665 F.Supp. at 305. Although the district court could have been more deliberate by specifically holding that March 1st was the closing date, we are satisfied that it found that March 1st was the date set for closing.

In view of the above, we conclude that not only was March 1st the closing date, but also that the commitment

expired on that date. We acknowledge that the parties' conduct in continuing to negotiate after March 1st may be consistent with an implied extension of the expiration date. We observe, however, that Penthouse and Queen City had allowed the commitment to expire by its own terms once before. Thus, we do not believe that our conclusion here is at odds with the parties' expectations. In holding that the commitment expired on March 1st, we simply construe the terms of relatively unambiguous documents. The parties bargained for a loan commitment that remained open only for a stated duration and we are not at liberty to construe that agreement in a manner inconsistent with its clear language.

B. ***Existence of an anticipatory breach.***

We now turn to the direct court's factual findings and legal conclusions concerning the existence of an anticipatory breach. The district court determined that "Dominion's representatives' conduct and statements amounted to a clear refusal to proceed to closing unless conditions beyond those required by the Loan Commitment were first met." 665 F.Supp. at 310. As examples of Dominion's "clear refusal to proceed," the district court relied on 1) Gorelick's insistence on the proposed amendments to the Helmsley Lease, 2) Dominion's alleged insistence that a hotel management agreement be in place prior to closing, 3) Dominion's alleged requirement that Penthouse hire Sigal, and 4) Dominion's alleged demand that it replace Queen City as lead lender. Pointing out that three of the four examples the district court took into account when it found that an anticipatory breach occurred all took place after March 1st, Dominion argues that the district court erred as a matter of law by considering Dominion's post-March 1st conduct. In addition, Dominion contends that, when only its pre-March 1st

conduct is taken into account, it is clear that it did not by word or conduct commit an anticipatory breach. We agree.

"Ordinarily no action for damages or for restitution can be maintained until the time for performance has come and there has been an actual failure to perform." *Miller & Sons Bakery Co.* v. *Selikowitz*, 8 N.J. Super. 118, 73 A.2d 607, 609 (1950). Nevertheless, "where . . . one party [to a contract] either disables himself from performing, or prevents the other from performing, or repudiates in advance his obligations under the contract, and refuses to be longer bound thereby, communicating such repudiation to the other party," the non-breaching party "is not only excused from further performance . . ., but may at his option treat the contract as terminated for all purposes of performance, and maintain an action at once for damages occasioned by such repudiation, without awaiting the time fixed by the contract for performance by the defendant." *Dun & Bradstreet, Inc.* v. *Wilsonite Products Co.*, 130 N.J.L. 24, 31 A.2d 45, 47 (1943) (quoting *O'Neill* v. *Supreme Council American Legion of Honor*, 70 N.J.L. 410, 412, 57 A. 463, 464 (1904)).

"An anticipatory breach is a definite and unconditional declaration by a party to an executory contract—through word or conduct—that he will not or cannot render the agreed upon performance." *Ross Systems* v. *Linden Dari-Delite, Inc.*, 35 N.J. 329, 173 A.2d 258, 264 (1961) (citations omitted). Likewise, "[i]f one party to a contract, either willfully or by mistake, demands of the other a performance to which he has no right under the contract and states definitely that, unless his demand is complied with, he will not render his promised performance, an anticipatory breach has been committed." 4 A. Corbin, Corbin on Contracts § 973, p. 910 (1951).

The term anticipatory breach is self-defining as one which occurs before the time of performance and while the contract is in existence. As we concluded above, March 1st was the closing date and the expiration date for this loan transaction. Thus, we are compelled to agree with Dominion's argument that the district court erred as a matter of law when it took into account Dominion's post-March 1st conduct when determining the existence of an anticipatory breach. Only Dominion's conduct before March 1st is relevant to the determination of whether an anticipatory breach has occurred, and taking only that conduct into account, we conclude that the district court clearly erred when it found that Dominion committed an anticipatory breach.

New Jersey adheres to the view that an anticipatory breach occurs only if there is a "*clear and unequivocal declaration*" that "the agreed upon performance would not be forthcoming." *Seitz* v. *Mark-O-Lite Sign Contractors, Inc.*, 210 N.J.Super. 646, 510 A.2d 319, 324 (1986) (emphasis added); *see Ross Systems Inc.*, 35 N.J. 329, 173 A.2d at 264; *Miller & Sons Bakery Co.*, 8 N.J. Super. 118, 73 A.2d at 609; *see generally* 4 A. Corbin, Corbin on Contracts § 973 (1951). "Doubtful and indefinite statements that performance may or may not take place and statements that, under certain circumstances that in fact do not yet exist, the performance will not take place," will not give rise to a claim for anticipatory breach. 4 A. Corbin, Corbin on Contracts § 973, p. 905 (1951) (footnote omitted).

In recounting the evidence concerning Gorelick's conduct at the February 9, 1984 preclosing meeting, the district court found that "[t]he overwhelming evidence shows that Gorelick's demands were equal to a demand that the deal be completely done over[.]" 665 F.Supp. at

307. Subsequently, the court found that "[t]hroughout February *and March*, Dominion, through the Melrod firm, continued to make requests for more information which Newman described as 'never ending.' . . . Dominion further demanded numerous changes in the way the entire deal was to be structured, the parties involved, and other changes not required by the Loan Commitment." *Id.* at 309. When, however, the court sought to provide specific examples of the "changes not required" by the commitment, the only one that occurred before March 1st was Gorelick's demands concerning amendments to the Helmsley lease. The evidence established that Gorelick did in fact insist that the proposed amendments were "required." Thus, the issue we confront is whether Gorelick's insistence on the proposed amendments represented a demand for performance for which Dominion had no right and whether his insistence amounted to a "definite and unequivocal refusal" by Dominion to fulfill its obligations under the agreement unless this condition was met.

It is undisputed that, unless amended, the Helmsley lease would have been violated by the closing of the Queen City deal. Because the loan commitment required that there be "no violations" of that lease at closing, it is clear that some amendments were necessary to satisfy the terms of the loan commitment. To this end, the Melrod lawyers submitted a list of proposed amendments to Penthouse. Even though Gorelick insisted that each proposed amendment was required, when the proposed amendments were sent to Penthouse, Dominion's position was equivocal. Trotter's cover letter indicated that the amendments represented what Dominion would be "looking for" and would provide Penthouse "with a jumping off point" for its negotiations with Helmsley. Thus, Gorelick's state-

ments that the proposed amendments were required clearly were qualified by the statements made in Trotter's cover letter.

In addition, we observe that the list of proposed amendments was just that—a proposal. With the proposed amendments, it was contemplated that Penthouse would then engage in negotiations with Helmsley. As indicated in Trotter's letter, the proposed amendments constituted a starting point for the negotiations with Helmsley, but they did not represent Dominion's "final" position. Viewed in this light, we are persuaded that the district court clearly erred when it found that Gorelick's insistence on the proposed amendments gave rise to an anticipatory breach. New Jersey consistently requires that the breaching party in these cases make a "clear and unequivocal declaration" that performance would not be forthcoming and Gorelick's conduct in this regard falls short.

Nevertheless, we are left with the court's general finding that Dominion refused to perform unless the entire deal was restructured. As pointed out above, most of the specific instances of conduct cited by the court occurred after March 1st and thus are not relevant to our inquiry. We do confront, however, the district court's findings that Gorelick demanded at the February 9th meeting that everything in connection with the deal be "completely done over." We observe that Gorelick was so adamant in this regard that the parties allowed him to assume responsibility for drafting the closing documents and reviewing condition compliance. Thus, it is arguable that his demands at the February 9th meeting were sufficiently clear and unequivocal to give rise to an anticipatory breach if his refusal to proceed was unjustified.

When Gorelick attended the February 9th meeting, he only recently had been brought into the deal. He was there to represent his client's interests in connection with its agreement to participate in a $97 million construction and permanent financing transaction, of which more than a third was to be funded by his client. At the time of the preclosing meeting, the parties contemplated closing the transaction within a few weeks—by March 1st at the latest. At the meeting or shortly before, Gorelick discovered that there were significant problems affecting title and problems with the Helmsley lease and yet there were no active negotiations to resolve those problems. Gorelick also learned that Queen City intended on closing the transaction without insisting that Penthouse comply fully with all of the preclosing conditions. In addition, he received draft loan documentation which, in his judgment, was amateurish and substandard for a transaction of this magnitude.

While we do not pass upon the reasonableness of each of Gorelick's objections, we note that Nelson's expert testimony fully supported Gorelick's position that the transaction was not in a position to close any time in the near future. We also note that although the district court found that some of Gorelick's objections were unreasonable, it did not find that most of his concerns were unfounded. Gorelick attended the preclosing meeting in order to ensure that the interests of his client were protected. In so doing, he insightfully observed serious problems with the transaction and promptly raised his objections. Gorelick's insistence on marketable title in the face of the objections reported by the title company all by itself would justify his position that the deal was in no position to close and thus cannot, as a matter of law, constitute an anticipatory breach. Coupling the title and lease problems with Pent-

house's failure to establish that it was in a position to fully satisfy all of the preclosing conditions, we conclude that Gorelick properly refused to proceed unless his concerns were addressed. We therefore conclude that the district court clearly erred when it found that Dominion committed an anticipatory breach of its agreement to participate. Accordingly, we reverse the judgment entered against Dominion.

C. ***Plaintiffs' ability to perform.***

As part of this damages action for an alleged anticipatory breach, Penthouse bore the burden of establishing its willingness and ability to perform all of the obligations under the agreement. As Professor Corbin has explained,

> *[i]n an action for breach by an unconditional repudiation it is still a condition precedent to the plaintiff's right to a judgment for damages that he should have the ability to perform all such conditions.* If he could not or would not have performed the substantial equivalent for which the defendant's performance was agreed to be exchanged, he is given no remedy in damages for the defendant's non-performance or repudiation. Of course, the willingness and ability that remains a condition precedent in spite of the defendant's repudiation, is willingness and ability to perform if there had been no repudiation.

4 A. Corbin, Corbin on Contracts § 978, pp. 924-25 (1951) (emphasis added) (footnote omitted). New Jersey follows this general rule. *See Bertrand* v. *Jones*, 58 N.J.Super. 273, 156 A.2d 161, 168 (App.Div.1959) (following Corbin), *certif. denied*, 31 N.J. 553, 158 A.2d 452 (1960); *cf. Caporale* v. *Rubine*, 92 N.J.L. 463, 105 A. 226, 227 (1918) (in breach of contract action for damages, plaintiff has the burden of establishing "that he was able and ready to

perform his part of the undertaking"); *accord Korb*, 24 N.J.Super. 151, 93 A.2d at 581 (in an action for specific performance, plaintiff must establish that he is "ready, desirous, prompt and eager to perform the contract on his part").

That the plaintiff must establish its readiness and ability to perform does not mean that it is required to tender performance. After the occurrence of an anticipatory breach, "[i]t is no longer necessary for the plaintiff to perform or tender performance." 4 A. Corbin, Corbin on Contracts § 977, p. 920 (1951) (footnote omitted); *see Dun & Bradstreet*, 130 N.J.L. 24, 31 A.2d at 47. This is so because "[t]he defendant's wrongful repudiation justifies the plaintiff in taking him at his word and at once taking steps that may make subsequent performance impossible." 4 A. Corbin, Corbin on Contracts § 978, p. 925 (1951). Nevertheless, the plaintiff must demonstrate that it had the willingness and ability to perform "before the repudiation and that the plaintiff would have rendered the agreed performance if the defendant had not repudiated." *Id.*

In the instant case, the district court found that "at the time of the preclosing meeting, all of the conditions precedent had been met, waived, or were in a position to have been met by the date set for closing the loan." 665 F.Supp. at 310. Thus, it found that Penthouse was ready, willing and able to proceed by the time of the alleged anticipatory breach. In challenging this conclusion, Dominion argues that Penthouse had not met and could not have met its obligations to convey valid mortgages and to satisfy certain of the preclosing conditions and that the district court's findings in this regard are clearly erroneous. Dominion also argues that the district court erred in concluding that certain conditions had been waived, contending that Queen City had no authority to waive pre-

closing conditions. Dominion concludes that, when properly viewed, the evidence demonstrates that Penthouse was in no position to satisfy the preclosing conditions on or before March 1st and thus failed to establish that it was ready, willing and able to proceed. We agree.

Despite the fact that Penthouse and Queen City never argued at trial that any of the preclosing conditions had been waived, the district court determined that Penthouse's full compliance with preclosing conditions 10, 11, 12 and 16 had been waived as a result of Lipari's meetings with Penthouse during the January 1984 status conferences. The district court's waiver finding was integral to its determination that Penthouse was ready, willing and able to perform by the closing date because, in the absence of a waiver, it is clear that those material preclosing conditions were not and could not have been satisfied by March 1st. Penthouse offered at trial no evidence to contradict Nelson's opinion that it would have taken at least 60 days, and more than likely 6 months, from February 9, 1984 for Penthouse to comply with all of the preclosing conditions. Nelson's prognosis changed only after the district court inquired as to how long it would have taken to close if the unsatisfied preclosing conditions had been waived. Although he bristled at the suggestion that those preclosing conditions would ever be waived by a prudent lender—let alone an institutional lender—he testified that, assuming a waiver, the loan could have been closed as soon as the papers were drawn up. In the face of this testimony, we must squarely decide the propriety of the district court's waiver finding. This inquiry requires, in turn, that we examine whether Queen City had the authority in the first instance to waive Penthouse's compliance with preclosing conditions. We conclude that it did not.

Before we inquire into Queen City's authority to waive compliance with preclosing conditions, we must examine the nature of Dominion's agreement to participate. On November 21st, Dominion entered into an agreement with Queen City whereby it agreed to participate in the lending syndicate to the extent of $35 million. That agreement was embodied in several documents which, in turn, incorporated the terms and conditions of *both* the Queen City loan commitment and the participation agreement. When construing Dominion's agreement, we read these documents "together as one instrument, and the recitals in one may be explained or limited by reference to the other." *Schlein* v. *Gairoard*, 127 N.J.L. 358, 22 A.2d 539, 540-41 (1941); *see Schlossman's Inc.* v. *Radcliffe*, 3 N.J. 430, 70 A.2d 493, 495 (1950). Applying this rule, we therefore look to terms of both the loan commitment and the participation agreement when examining whether Queen City had the authority to effect a waiver of preclosing conditions.

The loan commitment provided that "[a]ll title questions and all other legal matters relating to or arising out of the Loan shall be subject in all respects to the approval of the Lender's counsel . . . and the decision of the Lender's counsel as to whether all conditions of the commitment have been met shall be final." The commitment also provided, however, that "[l]ender's obligation to close the loan is contingent upon the satisfaction of each of [the preclosing] conditions." Reading these two provisions together, we conclude that, although Queen City had the final word on whether the preclosing conditions had been satisfied, Penthouse nevertheless was required to satisfy each of the preclosing conditions. Thus, Queen City was granted essentially administrative authority to oversee the manner in which the preclosing conditions were satis-

fied, but it was not empowered to waive Penthouse's compliance with the preclosing conditions.

The participation agreement further limited Queen City's authority in connection with the administration of the loan transaction. It expressly provided that its terms could not be modified except by an agreement in writing. Thus, Queen City was not empowered to modify the terms or conditions of the participation agreement without obtaining the participants' prior approval. In addition, when the participants entered into the agreement with Queen City, they only authorized Queen City to act on their behalf in the capacity of an independent contractor; Queen City was not authorized to act as their agent. To this end, Queen City was given discretionary power as to the means and manner of contractual performance, *see, e.g., Errickson* v. *F.W. Schwiers, Jr. Co.*, 108 N.J.L. 481, 158 A. 482, 483 (1932), but was not empowered to make material changes that rendered the participants less secure. Even if we were to conclude that Queen City was authorized to act as agent for the participants, it would not have been empowered to waive or alter material terms "or otherwise to diminish or discharge the obligation of the third person[.]" *See* Restatement (Second) of Agency § 51 comment C (2d ed. 1979).

In view of the above, it is clear that Queen City was not authorized expressly or inferentially in the commitment or the participation agreement to modify the terms of the commitment by waiving Penthouse's full compliance with preclosing conditions. In addition, when Dominion was first informed concerning the full extent of Penthouse's proposed substitute performance for preclosing conditions 10, 11, 12 and 16, Gorelick objected. Then, after the Melrod firm was given responsibility for reviewing condition compliance and Gorelick transmitted his various

checklists, it was made clear that Dominion expected that Penthouse would comply with the terms of each preclosing condition. Thus, there could be no implied waiver of these conditions here, either. We therefore conclude that the district court erred when it found that Queen City waived Penthouse's full compliance with preclosing conditions 10, 11, 12 and 16. Because Queen City could not waive these conditions in the first place, it could not accept Penthouse's substitute performance without first obtaining the participants' approval.

Sound national banking policies support the conclusion we reach here. As *amicus curiae* Federal Home Loan Bank Board points out:

> the proposition . . . that a lead lender may, without consulting participating lenders, waive or modify significant conditions of a loan to the detriment of participants, seriously undermines the Bank Board's supervisory policies concerning safe and sound underwriting of participation purchases and is completely at odds with the Bank Board's policy that loan participants must satisfy themselves that the participation is a loan that the participating association would make itself.
>
> If a lead lender has this authority . . ., the Bank Board's supervisory control regarding underwriting of participation purchases is rendered more difficult or impossible and the FSLIC fund is exposed to inordinate risk. A savings and loan association's independently and prudently underwritten participation in a loan could be changed into an entirely reckless act if fundamental terms and conditions of the loan are altered prior to closing by the lead lender on its own initiative and without consulting the participant. This would make it very difficult, if not impossible, for a participant to assure prudent underwriting or participations.

While we do not necessarily find that these policy considerations by themself are binding if the parties had agreed otherwise, they certainly militate against the district court's unsubstantiated and erroneous finding that Queen City had the authority to waive various essential preclosing conditions.

As a separate matter, Dominion contends that the district court's other findings that bore upon Penthouse's ability to perform were erroneous. The district court found that the outstanding title and lease problems were "minor," 665 F.Supp. at 310, and that "the entire matter could have been resolved in time to close the deal before March 1, 1984." *Id.* at 305. The district court also held that, although licensing discussions with the Casino Control Commission "were to resume after the closing, . . . it appeared an arrangement with the Commission was easily within reach." *Id.* Dominion argues that, notwithstanding the court's characterization, the title and lease problems were not minor and that there was no evidence to support the court's conclusion that these matters could have been resolved by March 1st. With regard to its finding concerning the licensing arrangements, Dominion contends that it supports the view that Penthouse could not have satisfied this preclosing condition before closing and that the court's characterization that these arrangements were "easily within reach" is belied by the evidence. We agree with both of Dominion's contentions.

Turning to the court's findings concerning the title and lease problems, we are compelled to conclude that the district court clearly erred when it characterized these matter's [sic] as being "minor." Unless these problems were resolved, they absolutely would have prevented Penthouse from delivering the title required in the commitment. Likewise, unless the Helmsley lease was modi-

fied, Penthouse could not certify that there were "no violations" of that lease. Thus, in view of the gravity of these problems, Penthouse knew that they had to be resolved by the closing date. We therefore cannot conclude that they were "minor."

In addition, the district court's characterization of the title and lease problems as "minor" presupposed that several contingencies could and would occur to resolve them before closing. As Nelson described the situation, since Helmsley was a sophisticated participant in real estate transactions, there probably would be no insurmountable barriers to reaching an accord with him to address the title and lease problems, "but it would take time and probably money." Thus, the court may have believed that the problems were minor because they could have been resolved in time and with money. To reach an agreement resolving these problems, however, it was incumbent upon Penthouse to commence negotiations. Thus, the district court's conclusion that these matters were minor and resolvable by March 1st rested on the assumption that negotiations with Helmsley were "ongoing" and would be concluded favorably before March 1st. This assumption was erroneous.

Both Myerson and Newman testified that actual negotiations with Helmsley had not occurred by February 9th. Although Newman had made indirect contact with Helmsley's attorney, no formal proposals had been submitted and no negotiations had begun. This uncontradicted evidence leads us to conclude that the district court clearly erred when it found that negotiations with Helmsley were "ongoing." Negotiations cannot be characterized as "ongoing" when they have not even begun. The absence of ongoing negotiations undermines the district court's finding that the title and lease problems could have

been resolved before March 1st, and no evidence in the record indicates that negotiations would have commenced by March 1st, let alone be concluded by that date, to resolve the problems with the lease and title.

In addition, Penthouse failed to establish that it was working toward clearing up the problems posed by the McShane and Chase mortgages. Those mortgages had to be subordinated in order for Penthouse to provide the security required by the commitment and Penthouse apparently had not even made contact with the holders of those mortgages. This fact plus the problems surrounding the Helmsley lease lead us to conclude that the district court's factual finding that these problems could have been resolved by March 1st is clearly erroneous.

With regard to the court's finding concerning the status of the alternative licensing arrangements condition, we note that the district court overlooked the fact that this was a *preclosing* condition. Because the court found that those arrangements could have been made *after* closing, it is clear that Penthouse did not carry its burden to demonstrate its ability to perform this condition *before* closing. In addition, we observe that record evidence does not support the district court's finding that these arrangements were "easily within reach." Goldstein's letter clearly indicated the tentative nature of his proposal. He described it as a "rough outline" of what he thought "might be acceptable" to the CCC. From Goldstein's letter, it is clear that no arrangements had actually been made. Presumably, Penthouse and the lenders were going to have to draft agreements for the alternative licensing arrangements. This would take time. Therefore, due to the tentative status of the proposed alternative arrangements and the absence of an actual agreement, we are convinced that the district court also erred in this regard.

In view of the foregoing, we conclude that Penthouse failed to carry its burden at trial to demonstrate that it was ready, willing and able to perform its contractual obligations at any time before March 1st. Thus, even if we were to agree that Dominion had refused to perform, we would nevertheless be compelled to conclude that it could not recover damages. We could conclude that Penthouse's failure to demonstrate that it could deliver marketable title by March 1st would be a complete answer to a charge of anticipatory breach. When, however, the title and lease problems are combined with Penthouse's inability to perform the various preclosing conditions, we are left with the firm belief that it should not be entitled to recover on its complaint for an anticipatory breach. Accordingly, the judgment in favor of Penthouse is reversed.

D. ***Damages.***

Having found that Penthouse failed to establish the essential elements of its anticipatory breach claim, we need not address the merits of the district court's award of lost future profits. Nevertheless, we are compelled to point out that the case upon which the district court relied when holding that the lost profits were recoverable may not be good law. In reaching its decision on the damages issue, the court relied on our decision in *Perma Research & Development* v. *Singer Co.*, 542 F.2d 111 (2d Cir. 1976), a diversity action involving questions of New York law. Since our decision in *Perma Research*, however, New York's highest court has considered the damages issue decided in *Perma Research* and has flatly rejected the rationale of that decision. *See Kenford Co.* v. *Erie County*, 67 N.Y.2d 257, 502 N.Y.S.2d 131, 493 N.E.2d 234 (1986) (per curiam). In view of the New York Court of Appeal's decision in *Kenford*, the rationale of our decision on the damages issue in *Perma Research* is seriously in doubt

and we conclude that the district court's reliance on that case was misplaced.

II. DOMINION'S APPEAL OF QUEEN CITY JUDGMENT

A. *Anticipatory breach claim.*

After it concluded that Dominion was liable to Penthouse for Dominion's alleged anticipatory breach, the district court addressed Queen City's claim, stating:

> Queen City counterclaims against Dominion for breach of its obligations to Queen City. As a direct result of Dominion's failure to close the loan, Queen City claims to have suffered a loss of profits it otherwise would have earned. In one of the documents signed November 21, 1983 Dominion accepted the Queen City commitment . . ., and thus, Dominion's breach gives rise to claims by all parties to which it was contractually obligated. Having held that Dominion breached its agreement, I must also find it liable to Queen City for that breach.

665 F.Supp. at 312. Thus, when the district court held in favor of Queen City on the counterclaim, the court based its decision solely upon its earlier conclusion that Dominion committed an anticipatory breach. In view of our determination that the court erred in concluding that Dominion committed an anticipatory breach and that Penthouse was ready, willing and able to proceed by March 1st, we reverse the judgment entered in favor of Queen City. Because Dominion's conduct did not amount to an anticipatory breach, it is not liable to Queen City on the counterclaim. Likewise, because Penthouse did not establish that it could have satisfied the preclosing conditions before March 1st, Queen City is also precluded from recovery against Dominion.

B. *Dismissal Of Dominion's cross-claim.*

Dominion contends that the district court erred when it dismissed with prejudice its third-party claim against Queen City. Dominion predicated its theory of Queen City's liability on the argument that, if Queen City did in fact waive four preclosing conditions, in so doing it breached its fiduciary duties owed to Dominion and the other participants. Because, however, we conclude that no waiver occurred—because Queen City had no authority to waive conditions—it follows that Queen City is not liable for any purported waiver. Accordingly, we affirm the district court's dismissal of this claim.

III. THE MELROD FIRM'S APPEAL OF PENTHOUSE JUDGMENT

A. *Background.*

Nowhere in the district court's reported opinion did it find that Dominion or the Melrod firm committed fraud. The entire decision was devoted to a discussion of Dominion's alleged anticipatory breach and the damages resulting therefrom. There was no suggestion that Gorelick and the Melrod firm were to be held liable for the Penthouse judgment. In addition, while the district court made findings concerning Dominion's alleged undisclosed intent and Gorelick's purported role as "hatchet man," we observe that the court found no fraud or misrepresentation concerning the November 21st agreement and made no other specific findings with regard to subsequent events or statements suggesting that fraud was committed. Indeed, although Penthouse specifically sought in the pretrial order a finding that its agreement to pay the Melrod firm's fees was void and unenforceable (a claim that was part of the fraud count in its complaint), the district court never made such a finding.

After the district court issued its reported decision, the parties submitted proposed judgments. Penthouse's proposed judgment form requested from the Melrod firm approximately $1.7 million, not the $128.7 million amount of its anticipatory breach judgment. In contrast, in addition to submitting its proposed judgment, the Melrod firm submitted a letter to the court in which it argued that it had been exonerated and should be free of liability. In response to these two conflicting proposed judgments, the district court filed an order dated September 30, 1987, in which it held the Melrod firm jointly and severally liable for the $128.7 million Penthouse judgment. Explaining its rationale for this decision, the district court stated:

> It is urged that the law partnership was merely an agent for a disclosed principal and as such could not be liable for any wrongdoing. This argument ignores two items: first, the firm did not disclose the true nature of the agency which it undertook; and, the actions of the firm through its partner constituted active fraud. The analogy that comes to mind when considering the law firm's argument is that of a hoodlum enforcer for a loan shark claiming innocence as the agent of a disclosed principal. In this case the Melrod firm did not disclose the true nature of its agency, *i.e.*, to scuttle the deal and cause damage to the plaintiffs and others. Certainly no one can imagine Philip Gorelick coming to the pre-closing meeting to tell everyone that he had been delegated to subvert the deal.
>
> For some unexplained reason the various judgments submitted do not name the Melrod firm as a judgment debtor for the lost profits. This may be occasioned because of a defect in the pleadings at the start of the trial. As part of the pro forma disposition of the "usual motions" made at the end of the case, I granted the "usual" motion to conform the pleadings to the proof. Thus it is appropriate and just for the Melrod

> firm to stand as a joint and several debtor for the profits lost by the Penthouse plaintiffs.

Notwithstanding the district court's assertions, no motions—"usual" or otherwise—to conform the pleadings to the proof appear in the record.

Thereafter, the Melrod firm filed a motion for a new trial in which it argued *inter alia* that the robing room incident, the court's bias against Gorelick and its *sua sponte* order holding the Melrod firm jointly and severally liable on a fraud theory all constituted reversible error and merited a new trial. In an order dated December 2, 1987, the district court denied the Melrod firm's motion. In that order, the court first concluded that it had not prejudged the case against the Melrod firm and had treated Gorelick appropriately, and then, turning to its *sua sponte* order, the court stated:

> [t]he last item raised in this motion for a new trial is a claim by the Melrod law firm that it was denied a fair trial because after the trial was finished I deemed the pleadings amended to make them responsible for all of the damages rather than the approximately $3 million for which they originally thought that they were potentially liable. Like the others, this claim also lacks substance. Somehow the Melrod firm claims that they were unprepared to defend against such a large claim. This ignores the fact that both Melrod and Dominion had but one counsel and he was totally prepared. Loss of the case by defense counsel cannot be attributed to anything other than the fact that the defendants were wholly responsible for the injury which they caused by illegal means. No counsel could change the facts. The one trial counsel for the two parties was as prepared as anyone could have been. Melrod's claim apparently, however, is not that they were unprepared to meet the allegations of the complaint as amended, but rather that they are now unprepared to pay the sum of money for which they

have been held liable. Clearly this is not grounds for a new trial.

B. ***The Melrod firm's claims.***

The Melrod firm presents a multitude of arguments in favor of reversal of this judgment. The firm argues that the trial itself was rendered unfair by the district court's premature assessment of Gorelick's credibility (as demonstrated by the robing room incident) and the court's excessive intervention during trial. The Melrod firm also contends that the court's perjury finding, by itself, was both legally and factually erroneous. Finally, the Melrod firm contends that the court's actions in holding it jointly and severally liable *sua sponte* violated the Federal Rules of Civil Procedure as well as due process.

The Melrod firm is not alone in challenging the fraud judgment. Dominion, joined by the Melrod firm, contends that, on the merits, the $128.7 million judgment cannot be sustained under a fraud theory.

C. ***Non-existence of fraud.***

Penthouse's fraud cause of action was set forth in Count III of its complaint. In that count, after realleging the facts surrounding the alleged anticipatory breach, Penthouse alleged the following: 1) On February 10, 1984, Dominion through the Melrod firm represented to Penthouse that Dominion was prepared to proceed with the loan closing according to the terms of the loan commitment, 2) the February 10, 1984 representation was false because Dominion did not intend to proceed with the loan unless Penthouse would agree to numerous additional conditions and terms that were not contained in the commitment, 3) in reliance on that representation, Penthouse entered into an agreement on February 10, 1984 to pay

Dominion's costs and legal fees, and 4) Penthouse suffered damages in excess of $1 million in addition to the nearly $32,000 paid for Dominion's legal fees. Thus, Penthouse's fraud theory was that, on February 10, 1984, the Melrod firm falsely represented to Penthouse that Dominion would proceed with its agreement to participate according to the terms of the loan commitment at a time when it in fact did not intend to proceed. In other words, Penthouse alleged that by February 10th Dominion no longer intended to fulfill its agreement to participate unless the commitment was restructured. Accordingly, Penthouse's position was that when Gorelick made statements on February 9-10, 1984 to the effect that Dominion intended to proceed, he committed a fraud for which his firm was liable.

The district court did not make factual findings in connection with Penthouse's fraud claim. Instead, it made its decision to hold the Melrod firm jointly and severally liable *sua sponte* and stated that the firm's actions constituted "active fraud." Thus, the court failed to make specific findings on each element of the fraud cause of action, i.e., that the Melrod firm—through Gorelick—knowingly made a false representation of present or past material fact with the intent to cause actual reliance and that Penthouse in fact relied on the misrepresentation to its detriment. The district court did, however, find that Gorelick attended the February 9th meeting for the sole purpose of sabotaging the deal and that Dominion did not intend on fulfilling its commitment at that time. Thus, if we assume that, on February 10th, Gorelick made the representations Penthouse claims, then, arguably, he would have made a false representation of Dominion's present intent which could give rise to a claim for fraud. At the bottom of the fraud claim, then, is the district

court's determination that, by February 9th, Dominion did not intend on fulfilling its contractual obligation and that it had hired Gorelick to break up the deal. Dominion contends that this finding is clearly erroneous. We agree.

In its opinion, the district court labored to develop a factual basis supporting its conclusion that Gorelick was called in by Dominion to "sabotage" the transaction. To find that by February 9th Dominion had decided to breach its commitment, the court relied on no testimonial evidence. Rather, the district court turned to a document offered in evidence and observed that "on its Commitment Participation Report for February, Dominion dropped Penthouse as a listed borrower." 665 F.Supp. at 306. The court then concluded that this was "almost conclusive proof that Dominion's officers had decided to breach its commitment by that time." *Id.* The district court did not recognize, however, that that report was not prepared in early-February, but was dated February 29th. Nor did the court take into account Dominion's Secondary Market Department's weekly list of loan commitments—also put into evidence—which indicated that Dominion carried the Penthouse participation on that list for every week through early-April 1984.

In addition to the unexplained omission of the Penthouse loan from Dominion's monthly report, the district court relied on Community's allegedly tenuous status when it found that Dominion intended to breach its commitment. The district court found that, by early-February, "Dominion should have been aware of Community's tenuous status as a loan participant." 665 F.Supp. at 306. Later, the court determined that, "[b]ecause of Community's withdrawal on February 29, Dominion was in the awkward position of having committed itself to lend more than the amount it was legally permitted to lend. . . .

Thus, Dominion either had to stall the closing until the loan expired and then withdraw from its commitment, or breach its commitment." *Id.* at 310.

The district court's factual findings belie its conclusion that Dominion intended not to proceed on February 9th. According to the court's reasoning, Dominion was not in this "awkward position" until late-February—when it allegedly dropped the Penthouse loan off the monthly report and purportedly received Community's withdrawal. Thus, even if we were to accept the court's findings regarding Community's withdrawal and the inferences to be drawn from the omission on the report, we would be compelled to conclude that the court clearly erred when it determined that this evidence established that Dominion intended not to proceed on February 9th.

Nevertheless, we also reject the court's finding regarding the timing of Community's withdrawal. Although Wienke had expressed his reservations about the transaction to Dominion and Queen City on February 8th and then to Gorelick and Myerson in late February, there is no evidence of Community's withdrawal prior to its March 20th letter. Thus, we conclude that the court clearly erred in this regard also.

Aside from the district court's erroneous factual findings, there is no other evidence establishing that Dominion intended not to proceed and there is abundant evidence to indicate just the opposite. Even after the commitment expired, Dominion indicated its continued interest in the transaction and maintained steady contact with Penthouse. And, it was Penthouse, not Dominion, who cut off communications. Thus, we conclude that there is no basis to conclude that Gorelick or Dominion harbored a secret intent not to proceed on February 9-10 or other-

wise. It therefore follows that, even assuming that Gorelick made a representation to Penthouse of Dominion's intent to proceed on February 10th, that representation of fact cannot give rise to a claim for fraud. Accordingly, the judgment entered against the Melrod firm is reversed.

Having concluded that Penthouse does not prevail on the merits of the fraud claim, it is unnecessary to pass on the several other arguments raised on this appeal. Nevertheless, we are quite concerned by the district court's conduct during the robing room incident as well as by its perjury finding. Suffice it to say that we believe that *ex parte* communications between the district court and only one of the litigants are rarely, if ever, looked upon with favor, even if intended to impart advice to a fellow member of the profession. With regard to the perjury finding, we are somewhat surprised by its presence in the court's decision. If the court viewed Gorelick's testimony as incredible, that is its prerogative as the trier of fact in a non-jury case, but unless perjury is at issue in a case, such a finding is not necessary once the trier of fact finds the witnesses' testimony incredible. The perjury finding here, however, was not only unnecessary but also was erroneous since it was not based upon clear and convincing proof. *See Barr Rubber Products Co.* v. *Sun Rubber Co.*, 425 F.2d 1114, 1120 (2d Cir.), *cert. denied*, 400 U.S. 878, 91 S.Ct. 118, 27 L.Ed.2d 115 (1970). Accordingly, we specifically reverse the finding.

CONCLUSION

In view of the foregoing, we reverse the judgments entered against Dominion and the Melrod firm in favor of Penthouse and against Dominion in favor of Queen City, affirm the dismissal of Dominion's cross-claim, and remand to the district court for the purpose of entering judgment in favor of Dominion and the Melrod firm and against Penthouse and Queen City dismissing the complaint and the related cross-action.

United States District Court

SOUTHERN DISTRICT OF NEW YORK

No. 84 Civ. 4325 (KTD).

PENTHOUSE INTERNATIONAL, LTD.,
and BOARDWALK PROPERTIES, INC.,
Plaintiffs,

v.

DOMINION FEDERAL SAVINGS & LOAN ASSOCIATION,
and MELROD, REDMAN & GARTLAN, P.C.,
Defendants.

DOMINION FEDERAL SAVINGS & LOAN ASSOCIATION,
Third-party Plaintiff,

v.

QUEEN CITY SAVINGS & LOAN ASSOCIATION,
Third-party Defendant.

Dec. 2, 1987.

MEMORANDUM AND ORDER

KEVIN THOMAS DUFFY, District Judge:

It seems that I come from another generation. It was once thought that the law was one of the highest of callings that a person could have, and a court was regarded as a temple of justice not to be desecrated by a lawyer telling lies. During that era, apparently now past, those called to

the law cared for one another as fellow members of the profession. A word of advice to save a colleague from an embarrassing situation, particularly advice from a judge, was accepted with gratitude. Now it seems that such a word of advice will be beaten into a shield to protect those who have profaned the court and who, by their prevarications, have sought to undermine justice.

After watching and listening to Phillip Gorelick testify for perhaps a total of four hours, I thought that much of what he had said was intentionally untrue. I knew that if this was not corrected by the witness I would have to find that he was a liar and that he had committed perjury. I thought that such a finding by a district court could have an adverse impact on him professionally and perhaps even personally. At that point my determination as to his credibility was purely preliminary; it was not set in concrete. Because I have not given up the ideals of my past, I decided to inform his counsel that if I found Gorelick to be a liar I would be obligated to articulate that finding. I did this by showing Gorelick's trial counsel the first line of *United States* v. *Tramunti*, 377 F.Supp. 1 (S.D.N.Y.1974), *aff'd in relevant part*, 513 F.2d 1087 (2d Cir.1975), *cert. denied*, 423 U.S. 832, 96 S.Ct. 54, 46 L.Ed.2d 50 (1975), which reads: "John Spurdis is a liar."

If I had made a final determination of Gorelick's credibility I could have remained silent and not given him a chance to redeem himself. The very fact that the conversation occurred can only mean that I made solely a preliminary determination and that good advice was being given to a lawyer by the court.

We must look then to what effect this had on Gorelick. Trial counsel told Gorelick of the conversation and, I am sure, intimated that he (Gorelick) would have to tell the

truth. This apparently occurred after Gorelick had finished his direct examination. Attorney Gorelick, who claimed expertise in the law, now claims that he thought he might be sent to jail for perjury and that therefore his nervousness caused the demeanor which I described in my first opinion in this case. Only pure speculation exists as to how this conversation might have so damaged Gorelick's "fragile psyche" that he was unable to tell the truth. Am I to believe this of a man who was chosen by the officers of Dominion Federal Savings & Loan Association ("Dominion") to break up a loan closing by bullying the other participants? Am I to believe this of the man who would make a secret bonus deal so that if he was unsuccessful for his client in breaking up the deal, he and his firm would still be enriched by $150,000 from the other side?

The problem with Gorelick's argument at this point is that much of what he testified to—which I found to be totally incredible—was testified to on his direct examination; at a time when my conversation with Mr. Tofel had not occurred. Gorelick's demeanor was that of a liar during his direct examination when questioned regarding those things about which he had decided to perjure himself. Indeed, often Gorelick attempted to avoid answering questions which were particularly pertinent to the transactions at interest. All of this occurred prior to the time of the conversation.

Counsel for the defendants now contend that they have been denied a fair trial, based on their claim that I made a determination as to credibility prior to the time that the witness finished testifying. This is just not so. The determination as to the credibility which caused me to advise counsel for Gorelick as to its possible consequences was not a final determination. Rather, it was made with the

hope that I would never have to make a final determination branding Gorelick as a liar. Nonetheless, it is clear from any fair reading of the record that Gorelick lied in many places. Did he really expect me to believe that the people at the Dominion Federal Savings & Loan Association made up their mind to "screw good faith" and break up the deal but did not tell him of that fact when they retained him as replacement counsel only one day before the preclosing conference? This is but one item in the litany of prevarications proffered by Gorelick as trial testimony in this action.

The conversation I had with Mr. Tofel, the record of the trial, and this motion, do not provide grounds for a new trial. Rather, when viewed together they prove that Gorelick's lies constituted knowing, willful perjury.

The defendants also raise two other items in an attempt to have this court grant their motion for a new trial: (1) that there is newly discovered evidence of such import that it would change the result of the trial; and (2) that the defendant Melrod was not expecting to be held liable for the full amount.

The newly discovered evidence basically concerns the fact that the plaintiffs were unable to obtain a loan for a period of about five years prior to the time the Queen City Savings & Loan Association ("Queen City") loan was obtained. It appears that this failure to obtain financing was caused by the misbehavior of one Melvin Weinberg, a confidential informant working for the FBI in connection with the ABSCAM matter. Weinberg apparently spread rumors that Guccione had some type of unsavory background and was unable to obtain a gaming license for a casino in Atlantic City. This apparently started in or about 1979. The fact that these statements were false was

brought out in the report published by the United States Senate Select Committee. This report confirmed that Guccione had no organized crime connections and that he had refused Weinberg's pressure to pay bribes. The report was made part of the package which was given to each of the participating banks in the transactions leading up to the Queen City commitment and the breach of that commitment caused by the defendants here.

The facts about the ABSCAM deal clearly were known to the defendants herein and to their counsel. It was mentioned at the time of trial both in testimony and in colloquy. At some time, however, after the start of the present action Guccione decided to sue the United States government for the wrong done to him and plaintiff here by Weinberg in *Guccione* v. *United States*, 670 F.Supp. 527 (S.D.N.Y.1987). Guccione claimed in that action, as part of his damages, his inability to obtain financing and a "Gaming License" for an Atlantic City casino during the period from 1980 to 1985. That entire period precedes the period for which damages were demanded in this case.

The defendants now claim that if they had known about the *Guccione* matter, they would have raised the defense of preclusion or demanded that Guccione and Penthouse International, Ltd. ("Penthouse") divide up the damages. This overlooks the fact, however, that the two cases are entirely different. The injuries claimed are different: one is for lost profits for the period 1980 to 1985; the other, for the period from 1985 to the present.

The defendants' argument that the *Guccione* action in some way affected their attack on Guccione's credibility lacks substance. They do not deny that they had all of the material underlying the action brought by Guccione; they do not deny that they had all of the other materials avail-

able which could impeach Guccione's credibility; and they cannot explain how the existence or non-existence of a lawsuit brought by Guccione involving another injury at another time could be used by them to attack his credibility. In any event, Guccione's credibility had little to do with the result in this case. Under all the circumstances, the claim by the defendants that they were denied a fair trial because they did not know of the action entitled *Guccione* v. *United States* is totally without merit.

The last item raised in this motion for a new trial is a claim by the Melrod law firm that it was denied a fair trial because after the trial was finished I deemed the pleadings amended to make them responsible for all of the damages rather than the approximately $3 million for which they originally thought that they were potentially liable. Like the others, this claim also lacks substance. Somehow the Melrod firm claims that they were unprepared to defend against such a large claim. This ignores the fact that both Melrod and Dominion had but one counsel and he was totally prepared. Loss of the case by defense counsel cannot be attributed to anything other than the fact that the defendants were wholly responsible for the injury which they caused by illegal means. No counsel could change the facts. The one trial counsel for the two parties was as prepared as anyone could have been. Melrod's claim apparently, however, is not that they were unprepared to meet the allegations of the complaint as amended, but rather that they are now unprepared to pay the sum of money for which they have been held liable. Clearly this is not grounds for a new trial.

Having considered all of the arguments raised by both defendants in this matter in their motions for a new trial, the motions are denied.

SO ORDERED.

United States District Court

SOUTHERN DISTRICT OF NEW YORK

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84 Civ. 4325 (KTD)

PENTHOUSE INTERNATIONAL, LTD.,
and BOARDWALK PROPERTIES, INC.,
Plaintiffs,

v.

DOMINION FEDERAL SAVINGS & LOAN ASSOCIATION,
and MELROD, REDMAN & GARTLAN, P.C.,
Defendants.

DOMINION FEDERAL SAVINGS & LOAN ASSOCIATION,
Third-party Plaintiff,

v.

QUEEN CITY SAVINGS & LOAN ASSOCIATION,
Third-party Defendant.

ORDER

KEVIN THOMAS DUFFY, D.J.:

By requiring the parties to settle an order, a judge has one last opportunity to review his decision and to clear up any ambiguity that might remain in the case. In this particular case such review has convinced me to restate certain aspects of my decision so that there will be no ambiguities.

In the law of contracts, recovery of damages is limited to the "benefit of the bargain." A defendant who has breached a contract is thus liable for neither more nor less than that. In my opinion in this case I talked about the expenses incurred in setting up the contract and in complying with the conditions precedent to that contract. I also discussed and set out the amount of the profits lost because of the wrongful acts of the defendants. If the contract had been fulfilled the plaintiff would have incurred the expenses involved in setting up the contract. The net profit, thus, would be the gross profit less those expenses.

In setting forth the profit amount in my opinion I deducted the amount found as expenses. The Judgment now proposed by the Penthouse plaintiffs seeks to add back those expenses. This I cannot allow.

The next question to be faced is whether interest should be permitted on the lost profits allowed. Everyone involved in this case agrees that such prejudgment interest is surely discretionary. With a verdict of great magnitude, coming about through the inexact science of measuring lost profits, I believe that prejudgment interest should not be allowed. Accordingly the judgment for the Penthouse plaintiffs will not include prejudment interest. This is not true as to the judgment for Queen City on its counterclaim. There the verdict was a mere mathematical calculation and the amount, while not insignificant, is not of the magnitude of the Penthouse judgment. Accordingly prejudgment interest is permitted on the Queen City judgment.

I turn now to two matters raised by the defendant Melrod firm. The firm not only suggested a form of judgment, but submitted a letter arguing that it should be exoner-

ated. It is urged that the law partnership was merely an agent for a disclosed principal and as such could not be liable for any wrongdoing. This argument ignores two items: first, the firm did not disclose the true nature of the agency which it undertook; and, the actions of the firm through its partner constituted active fraud. The analogy that comes to mind when considering the law firm's argument is that of a hoodlum enforcer for a loan shark claiming innocence as the agent of a disclosed principal. In this case the Melrod firm did not disclose the true nature of its agency, *i.e.*, to scuttle the deal and cause damage to the plaintiffs and others. Certainly no one can imagine Philip Gorelick coming to the pre-closing meeting to tell everyone that he had been delegated to subvert the deal.

For some unexplained reason the various judgments submitted do not name the Melrod firm as a judgment debtor for the lost profits. This may be occasioned because of a defect in the pleadings at the start of the trial. As part of the pro-forma disposition of the "usual motions" made at the end of the case, I granted the "usual" motion to conform the pleadings to the proof. Thus it is appropriate and just for the Melrod firm to stand as a joint and several debtor for the profits lost by the Penthouse plaintiffs.

Rather than have any further delay in the entry of the appropriate judgments, I have prepared and signed the judgments of the court. Those judgments shall be entered forthwith.

SO ORDERED.

DATED: New York
September 30, 1987

/s/ Kevin Thomas Duffy, U.S.D.J.
KEVIN THOMAS DUFFY, U.S.D.J.

United States District Court

SOUTHERN DISTRICT OF NEW YORK

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84 Civ. 4325 (KTD)

PENTHOUSE INTERNATIONAL, LTD.,
and BOARDWALK PROPERTIES, INC.,
Plaintiffs,

v.

DOMINION FEDERAL SAVINGS & LOAN ASSOCIATION,
and MELROD, REDMAN & GARTLAN, P.C.,
Defendants.

DOMINION FEDERAL SAVINGS & LOAN ASSOCIATION,
Third-party Plaintiff,

v.

QUEEN CITY SAVINGS & LOAN ASSOCIATION,
Third-party Defendant.

Filed Oct. 2, 1987

JUDGMENT

KEVIN THOMAS DUFFY, D.J.:

This action having come on for trial before the court, Hon. Kevin Thomas Duffy, United States District Judge, presiding, and the issues having been duly tried, and a decision having been duly rendered, it is

ORDERED AND ADJUDGED that plaintiffs Penthouse International, Ltd., 1965 Broadway, New York,

New York and Boardwalk Properties, Inc., 1965 Broadway, New York, New York recover of defendant Dominion Federal Savings & Loan Association ("DFSLA"), 7799 Leesburg Pike, Tysons Corner, Virginia and defendant Melrod, Redman & Gartlan, P.C., 1801 K Street, N.W., Washington, D.C., jointly and severally, the sum of $128,682,830.80 together with costs to be taxed in accordance with Rule 11 of the Rules of this court, and that plaintiffs have execution therefor, and it is further

ORDERED AND ADJUDGED that third-party defendant Queen City Savings and Loan Association ("Queen City") recover against defendant DFSLA the sum of $7,652,352.91, plus interest on that sum from January 1, 1987 at 10.5 percent per annum, in the sum of $504,111.79, amounting in all to $8,156,464.70, together with costs to be taxed in accordance with Rule 11 of the Rules of this court, and that third-party defendant Queen City have execution therefor, and it is further

ORDERED AND ADJUDGED that the counterclaim of DFSLA against plaintiffs be and hereby is dismissed with prejudice, and it is further

ORDERED AND ADJUDGED that the claims of DFSLA against third-party defendant Queen City be and hereby are dismissed with prejudice.

DATED: New York, New York
September 30, 1987

/s/ Kevin Thomas Duffy, U.S.D.J.
KEVIN THOMAS DUFFY, U.S.D.J.

United States District Court

SOUTHERN DISTRICT OF NEW YORK

No. 84 Civ. 4325 (KTD)

PENTHOUSE INTERNATIONAL, LTD.,
and BOARDWALK PROPERTIES, INC.,
Plaintiffs,

v.

DOMINION FEDERAL SAVINGS & LOAN ASSOCIATION,
and MELROD, REDMAN & GARTLAN, P.C.,
Defendants.

DOMINION FEDERAL SAVINGS & LOAN ASSOCIATION,
Third-party Plaintiff,

v.

QUEEN CITY SAVINGS & LOAN ASSOCIATION,
Third-party Defendant.

July 29, 1987.

As Amended July 30, 1987.

KEVIN THOMAS DUFFY, District Judge:

Plaintiffs, Penthouse International, Ltd. ("Penthouse") and Boardwalk Properties, Inc. ("BPI") (collectively "Penthouse") bring this action against the defendants Dominion Federal Savings and Loan Association ("Dominion") and Melrod, Redman and Gartlan, P.C. (the

"Melrod firm") for breach of an agreement to loan plaintiffs $97 million for the construction of a casino and hotel in Atlantic City, New Jersey. Dominion as third-party plaintiff claims that should it be found liable to the plaintiffs, the third-party defendant, Queen City Savings and Loan Association ("Queen City"), the lead lender on the transaction, must be found liable to Dominion.

The bench trial of this matter lasted three weeks, from May 11, 1987 until June 1, 1987. After consideration of the evidence and exhibits presented at trial, the following shall constitute my findings of fact and conclusions of law.

FACTS

Prior to 1983 and in connection with the casino and hotel project, Penthouse assembled five adjoining parcels of land, in Atlantic City, New Jersey, three of which it owned in fee, and two of which it leased. The Boardwalk & Missouri Corporation ("BMC") pursuant to a lease dated March 1, 1978 and amended March 13, 1979 (the "Helmsley lease") leased property on which a Holiday Inn Hotel was located to Penthouse. The Four Seasons Hotel was located on the second parcel of land assigned and leased to Penthouse by the Rothenbergs (the "Rothenberg lease"). Joint Pre-Trial Order ("PTO") ¶¶ 8-10.

Although Penthouse spent more than $60 million before 1983 in preparation for the proposed casino and hotel, they had experienced difficulty in obtaining financing for the completion of the project. PTO ¶¶ 11-12.

On about June 20, 1983 Queen City issued a written Mortgage Loan Commitment (the "Loan Commitment") to Penthouse in the amount of $97 million. PTO ¶ 14. Penthouse accepted the loan offer on June 29, 1983. PTO ¶ 14. Pursuant to the Loan Commitment, Queen City was

to be lead lender and was to lend $7 million on the loan while Penthouse was to procure additional participating underwriters for the loan. PTO Exh. A, Tr. 51. There were twenty additional conditions attached to the Loan Commitment.

In the spring of 1983, Jack Burke ("Burke"), a mortgage broker brought into the deal by Jefferson National Mortgage Company ("Jefferson National") to assist Penthouse in obtaining loan participants, along with other brokers, presented the possibility of participating in the Queen City loan to various officers of Dominion. Tr. 143. In June, 1983 certain mortgage brokers also brought the mortgage loan to the attention of Community Savings and Loan Association ("Community"), which decided not to become involved in the transaction at the time. PTO ¶ 15. Not until later did Community agree to participate in Dominion's part of the loan.

On November 21, 1983 a meeting was held at Penthouse's New York offices. In attendance were: David Myerson ("Myerson") the Executive Vice President of Penthouse and BPI; Marc Bendesky ("Bendesky") Penthouse's Director of Special Projects; Arthur Panero ("Panero:) a Consultant to Penthouse and BPI; Jay Newman ("Newman") a member of the Lefrak, Fisher and Myerson law firm (the "Lefrak firm") and counsel to Penthouse; John Beahan ("Beahan") the Senior Vice President of Queen City; Charles Filippo ("Filippo") of Queen City; John Lipari ("Lipari") counsel to Queen City; David Neal ("Neal") President of Dominion; Burke; Stephen Gavula ("Gavula") President of Epic, a mortgage brokerage company affiliated with Community, tr. 144; William Dorn ("Dorn") counsel to Dominion prior to the Melrod firm; Robert Geiger ("Geiger") Chairman of Jefferson National; and others. PTO ¶ 17.

At this meeting several documents were signed, PTO ¶¶ 19-20, and Dominion agreed to participate in the loan to the extent of $35 million, the amount not yet participated out. PTO ¶¶ 18-19. In form, Dominion's undertaking was absolute although Dominion planned to sell part of its participation to Community and to others. Tr. 779.

In light of Dominion's commitment, Queen City notified Penthouse that it had met condition number 19 of the Loan Commitment and that there were sufficient participants to provide the $97 million loan amount. PTO ¶ 22.

Because Dominion's legal lending limit was only $18.5 million, tr. 821, it had, by the November 21 meeting, obtained a "handshake" agreement with Community whereby Community had agreed to purchase one-half of Dominion's participation. Tr. 844-845, Neal Deposition, 88. The agreement between Dominion and Community was finalized in writing on December 2, 1983. PTO ¶ 23.

From December 1983 through February 1984, Dominion attempted, on behalf of itself and Community, to sell further participations in its $35 million commitment, with no success. Tr.350, 846-847. Dominion's Chairman of the Board, William Walde ("Walde"), testified that because of the difficulties Dominion was experiencing in trying to sell the loan, it felt it was "losing some credibility" in the market. Tr. 848.

After the $97 million was fully and finally committed, representatives of Penthouse and Queen City met on several occasions to review the status of the loan and to move it toward closing. Two status conferences were held on January 5 and January 16, 1984 for that purpose. Tr. 431, 487-488. No representatives of Dominion were in attendance at either status conference, nor did Dominion request that anyone be present. Indeed, no participant

other than Queen City, the lead lender, had any representative present. Each participating bank had committed itself to be a part of the Queen City package, each had accepted the conditions of the Queen City Commitment, each had accepted Queen City as the lead lender and none had requested any separate condition. It is clear, at least until the intervention of Phillip Gorelick, Esq. ("Gorelick"), that no participating bank had sought to become involved in reviewing the Queen City commitment conditions, leaving that solely to the lead lender and its counsel. At the meetings, Lipari reviewed each condition and discussed its status at the time.

These meetings were conducted in an attempt to resolve problems so that all the participating banks could attend a preclosing meeting and a closing of the entire loan at which the first advance would be made. The preclosing meeting was actually held on February 9, 1984 and will be discussed in detail below.

At the January 5 meeting, condition 16, requiring Penthouse to submit its architect's and construction contracts to Queen City for its review was discussed. Tr. 438, Plaintiff's Exh. 17. On January 5, Penthouse did not have an architect's contract in place, however, Panero explained that Penthouse had had architects prepare plans in 1978 and 1979 and that it preferred to proceed, at this point, with the engineer, DeSimone, rather than hiring another architect. It was explained that DeSimone would be capable of preparing or obtaining any additional drawings which might be necessary. Tr. 439, 544-545. DeSimone further explained that completed architectural plans were not generally provided in Atlantic City projects. Tr. 545. He noted that revisions would have to be made periodically to comply with changing building codes. Tr.

545. This arrangement was deemed sufficient by the lead lender. Tr. 439, 545.

Condition 16 further required that copies of contracts with the project manager and major trade contractors be submitted to Queen City for its approval. PTO Exh. A. The contract with Sodeteg, a French corporation hired to be the project manager ("Sodeteg"), had been negotiated a year earlier, tr. 543, and was in place on the date of the preclosing meeting, February 9, 1984. Tr. 439, 542-543, Plaintiff's Exh. 52.

Also, at the January 5 meeting, a representative of Sodeteg explained that it would not seek construction bids for other than the cement work until after the loan closed. Tr. 440-441, 493-494, Plaintiff's Exh. 17. Sodeteg explained that it would take bids from subcontractors instead of hiring a general contractor. Tr. 441. At the time of the status conferences, Sodeteg was involved in negotiations with a local construction manager it planned to hire to assist in selecting the various trade contractors. Tr. 545. Again, Lipari agreed to this procedure and Queen City's right to approve the contracts was agreed to be a continuing right. Tr. 441-442, 494, Plaintiff's Exh. 17. The agreement constituted a waiver of condition 16 which literally required that the major trade contractor's contracts be approved before the loan closing.

With respect to condition 12, which required that Penthouse deliver to Queen City an architect's certification containing final plans and specifications and a statement of full compliance with local, state, and federal ordinances and regulations, it was agreed that Queen City would accept the engineer's certification in place of an architect's certification. Tr. 439, 491-492, 545-547. The plans and specifications, as well as the certification, were subject to

the approval of Queen City's architect, Bob Rasmussen ("Rasmussen"). Tr. 442-444. Thus, condition 16 was waived to the extent that it required Penthouse to submit an architect's contract to Queen City for its approval. Moreover, the requirement that Penthouse submit an architect's certification was modified, so that submission of an engineer's certification was to be adequate compliance.

Condition 11, which required the lead lender's written approval of the plans and specifications for improvements, was also waived at the status conferences to permit Penthouse unilaterally to make changes not exceeding $100,000 for each change, or $2 million in total. Although the plans and specifications had been prepared several years before, the representatives of the lead lender agreed to accept them as fulfilling the condition, subject to necessary revisions. Thus, the plans and specifications were in place on the date of the preclosing meeting. Tr. 442-443, 492-493. Rasmussen, Queen City's architect, had reported that the plans were acceptable but not entirely complete and would require a few changes in the future to ensure compliance with particular building codes. Tr. 442-443. Queen City indicated its acceptance of this procedure as long as Rasmussen was satisfied with the changes. Tr. 444. Lipari testified that the revisions to the plans and specifications were not required prior to closing. Tr. 493.

The project budget, required by condition 13, was discussed and was in place by the preclosing date. Tr. 275, 444.

Myerson also covered the status of the casino licensing proceedings before the Casino Control Commission (the "Commission"). Tr. 450. Although the proceedings had

been temporarily suspended at Penthouse's request, tr. 285, they were to resume after the closing, tr. 285, and it appeared an arrangement with the Commission was easily within reach. Tr. 453-455.

Condition 10 required Penthouse to submit to Queen City copies of agreements providing for utility services to the casino and hotel. Plaintiff's Exh. 17. By the January 5 meeting, Penthouse had agreements with the suppliers of electricity, telephone, gas, and sewage services and had an agreement from the Atlantic City Municipal Utilities Authority. Plaintiff's Exh. 17. Lipari testified that he had agreed that the loan could proceed to closing on the basis of these agreements. Tr. 494. Thus, to the extent condition 10 could be interpreted as requiring anything more, it was waived.

Also during the status meetings and later, Lipari and Newman discussed the status of the title reports from Commonwealth Title. Tr. 495-496. Title searches on the property covered by the Helmsley lease revealed prior encumbrances and it was determined that Helmsley's consent would be needed in order to give Queen City and the other lenders a first leasehold mortgage. Tr. 496. Moreover, Helmsley would also be required to release certain declarations of easements to permit their subordination to Queen City. Tr. 497, 548. Although the title questions were unresolved on the date of the preclosing meeting, tr. 497, discussions had been initiated between Penthouse and Helmsley for resolving these matters. Tr. 549-551. Moreover, it is clear that the entire matter could have been resolved in time to close the deal before March 1, 1984.

In December 1983, however, Community hired a new underwriter who apparently decided to underwrite the

Penthouse loan after it had already become a participant. Wienke Deposition, 24. Generally, underwriting is done before a commitment is entered into, and even Dominion's Chairman of the Board, Walde, admitted that underwriting a loan subsequent to a commitment is simply bad banking practice, tr. 798-799, and in some cases can be a breach of contract.

In various internal meetings during December 1983 and January 1984, the new underwriter, Wienke, began to express a very negative view of the Penthouse loan. Wienke Deposition, 35-45. Whether Wienke's dissatisfaction was conveyed to Dominion is irrelevant, but it was not conveyed to the plaintiffs or to Queen City.

In early February 1984, Geiger, the original Penthouse broker, received a phone call from Gavula, a broker acting on behalf of Community, who requested that Geiger attend a meeting in Washington, D.C. The meeting took place on February 7, 1984 at Tiberios restaurant, only two days before the scheduled preclosing meeting. PTO ¶ 26. In addition to the brokers, representatives of Dominion, Community and Queen City were there. PTO ¶ 26. At this meeting, and in front of Neal and other Dominion representatives, Wienke stated that Community was opposed to hotel and casino loans for moral reasons. Tr. 148-150, 346-347. He further demanded to be provided with a long list of documentation not required by the Loan Commitment. Tr. 148, 346-347. Geiger objected to Community's attempts to underwrite the loan after the Commitment was in place. Tr. 347. Neal, however, stated that it was important to Dominion that Community receive the information it requested, tr. 149, because Dominion had to sell participations in the secondary market. Tr. 347. The meeting was adjourned until the next day, February 8, 1984, at Dominion's offices in Virginia. PTO ¶ 27.

Walde, the only officer from Dominion to testify in person at the trial, claimed that he did not attend the meeting on February 8, 1984, tr. 863, and that no one indicated to him that Community had expressed any problems with the loan or a desire to withdraw. Tr. 912. Other evidence, however, indicates that he did participate, at least sporadically, in that meeting and that he knew of Community's participation problems as of that date.

Even if Walde personally had no knowledge of Community's waivering participation, other officers of Dominion were fully aware of it. By letter dated February 3, 1984, Wienke requested a three page list of information from Bray, Dominion's Vice President, much of which was not required by the Loan Commitment. Joint Exh. 3. Wienke began by stating, "it is not possible at this time to reach a conclusion on the participation" and concluded the letter by stating "[o]nce we are in receipt of the above information we will commence our analysis promptly." Joint Exh. 3. Thus, Dominion should have been aware of Community's tenuous status as a loan participant by February 3, 1984 and certainly Dominion was aware by the Tiberios meeting. In fact, on its Commitment Participation Report for February, Dominion dropped Penthouse as a listed borrower. Tr. 900-906. I view this as almost conclusive proof that Dominion's officers had decided to breach its commitment by that time. Recognizing the potential liability they were incurring, Walde and his underlings sought a coverup. In this plot they found a willing tool in Gorelick.

Geiger testified that at the Tiberios meeting Wienke requested information about the cement, parking and other issues, which angered Geiger. When he stated that Dominion was not acting in good faith by underwriting the deal after its commitment, tr. 349-350, Walde replied

"Screw good faith. We're going to do it our way because we're the co-leader." Tr. 349-350. Walde thereafter announced that Dominion was hiring new legal counsel, Gorelick, to handle the transaction for them. Tr. 349, 387. Moreover, Neal also stated that Dominion's secondary market people had questions they wanted answered, tr. 350, or the deal would not close. Tr. 390-391.

On February 8, Neal called Gorelick and asked him to attend the preclosing meeting in New York the following day. Tr. 916-917. Gorelick then met with Neal, Bray, and Walde for about three hours. Tr. 918. Gorelick testified that Neal and Bray gave him numerous documents to review and asked him to assist in closing the loan for them. Tr. 918-919. He further claimed that they told him Community was a fifty percent participant with Dominion and that he was to copy Wienke on everything he did in reference to the loan. Tr. 1037. Gorelick claims, however, that neither Neal nor Bray told him anything about the February 7 or 8 meetings or about the problems they were experiencing with Community. Tr. 1035-1038. Gorelick's testimony is totally incredible.[1] Moreover, it is contradicted by Neal who stated that he believed he had given

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[1] The decision as to the credibility of witnesses is properly left to the trial judge or to the jury because as finders of fact they are in a position to view the demeanor of the witnesses.

Gorelick took the stand and attempted brazenly to lie to the court. During cross-examination, the crucible of truth, Gorelick continuously shifted uneasily in the chair, sweated like a trapped liar, and the glaze that came over his shifty eyes gave proof to his continuing perjury. His total lack of veracity was shown not only by his demeanor but by the shady practices he seemingly reveled in. He charged needless and exorbitant fees, Joint Exh. 41, for work that was intentionally unproductive. While representing the bank he demanded a $150,000 "bonus" from the borrower if the loan closed, an arrangement Gorelick never disclosed to his bank-client.

Gorelick a copy of Wienke's February 3 letter. Neal Deposition, 222. The inferences to be drawn from Gorelick's outrageous perjury are often the exact opposite of what he said. In particular, I make the finding that Dominion hired Gorelick to bully and intimidate the plaintiffs into delaying the loan until Community could be replaced or failing that, to delay until the Commitment expired and Dominion was released from its obligation.

The preclosing meeting was held the following day, February 9, 1984, at Penthouse's headquarters in New York. Tr. 498.

On the morning of February 9, the preclosing meeting began uneventfully. After Panero presented a display model of how the completed casino would look, tr. 552-553, Lipari distributed all the documents relevant to the loan transaction and went through each condition of the Loan Commitment discussing its status. Tr. 193, 498-499, 553. Thereafter, however, things rapidly fell apart. Although Gorelick's attendance during the meeting was sporadic, tr. 499, he indicated that he had comments to make and would do so after the morning session. Tr. 500. At the meeting Gorelick insisted on meeting with Myerson and Newman outside the hearing of the others.

Gorelick stated there were numerous problems with the loan, tr. 223, 502, that he would have expected to have seen additional documentation, tr. 503, and that the documents already prepared were "idiotic", inadequate and poorly drafted. Tr. 503, 554, 1047. Gorelick's objections were directed more to the form of the documents than to their substance. When confronted by Lipari about his specific objections to the documents, Gorelick replied that they were not prepared the way he would have done them and that the mortgage should have been twenty to thirty

pages in length. Tr. 353, 360-361. Gorelick then presented a lengthy list of documents and other items he wanted to see before he would recommend that his client close the deal. Tr. 223, 553-554. Gorelick expressed more concern with Dominion's ability to "participate out" its share of the Loan Commitment, tr. 365, than with closing the deal.

After hearing of Gorelick's complaints, Myerson was asked to assist at the preclosing meeting. Tr. 222, 225. Myerson then spoke with Gorelick in the hallway. Myerson stated that Gorelick "strenuously objected" to Lipari's papers, tr. 223, 225, and stated there would be no deal unless Gorelick took over and prepared the documents. Tr. 226. Moreover, Myerson's impression was that Gorelick objected to everything and that "everything presented was unacceptable" and had to be redone. Tr. 308-309. In his examination before trial, Gorelick tellingly stated that the loan was not "in a position to close at any time." Tr. 1047.

Feeling that cooperation with Gorelick was the only way to save the deal, Myerson asked Lipari to work with Gorelick by letting the Melrod firm prepare and review documents subject still to Lipari's ultimate approval. Tr. 310, 504-505.

Gorelick and Lipari then had a conversation in which Lipari testified that Gorelick was "abusive" and demeaning of Lipari's abilities. Tr. 505-506. When Lipari asked Gorelick how long it would take him to redraft the documents, Gorelick was unresponsive. Tr. 506. Finally Gorelick replied that he did not know if thirty additional days would be sufficient. Tr. 506.

Gorelick also spoke to Newman and told him that the loan would close only if Newman withdrew as counsel for

Penthouse and was replaced by an attorney from Washington, D.C. Tr. 555.

I do not find it necessary to rule directly on Gorelick's expertise, or lack thereof, in the field of real estate law. It is sufficient to say that the amount of learning and knowledge he and his partners displayed in this transaction was far from impressive. Even the expert called by the defendant disputed much of what Gorelick said.

The overwhelming evidence shows that Gorelick's demands were equal to a demand that the deal be completely done over, notwithstanding the fact that everyone in attendance at the preclosing meeting realized that the parties were still doing a number of things to prepare the deal for closing. At the time, there was simply no basis for not believing that the outstanding matters could be dealt with and the deal closed on schedule. Taken in context, Gorelick's actions at the preclosing meeting and afterwards establish his deliberate efforts to sabotage the deal. Myerson told Gorelick, when the parties reconvened in the conference room, that both Newman's firm and Lipari would assist him by providing all the documentation they could and by permitting Gorelick to prepare the loan documents to his satisfaction. Tr. 310, 556.

Before Gorelick would agree to do the additional work which he alone demanded to have done, he insisted on obligating someone to pay his fee. Tr. 229-230. He further told Myerson that he would "want to be paid for the trouble" of giving the case priority status. Tr. 948-949. He demanded specifically payment of both fees[2] and a

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[2] The fees collected by Gorelick and the Melrod firm under the heading "For Professional Services" included eleven hours work at $55 per hour by Ms. Higgins, Gorelick's secretary. Tr. 1386.

$150,000 bonus. Tr. 232, 949. Under the circumstances, Penthouse had little recourse but to give in to this extortion and a written agreement dated February 10, 1984 was signed by Gorelick and Myerson. Joint Exh. 55.

Rather than resuscitate the deal, however, Gorelick brought about its demise. Gorelick testified that it was his firm's responsibility to prepare the closing documents. Tr. 1064, 1068. Nevertheless, the only documents prepared were rough drafts of the promissory note, mortgage and deed of trust. None of these documents was sent to anyone to review. Tr. 982-983, 1064. Gorelick's claim that he never completed the documents because he was waiting for additional, necessary information, tr. 1064-1065, is completely incredible. I have no doubt that he was in fact waiting, not for information, but for the deal to fall apart. Putting the documents aside with a view toward finalizing them later, tr. 1065, and refusing to prepare numerous other documents even preliminarily, tr. 1068-1071, is not consistent with working diligently on a high priority deal. Dominion's own expert testified that these documents could be prepared overnight or in a very short period of time. Tr 1228-1229, 1330.

From the date of the preclosing meeting on, Gorelick became Dominion's hatchet man intent on destroying the deal. Yet, neither Penthouse, Queen City, nor any of the other participants knew the role he was playing. The very day Penthouse agreed to pay Gorelick's fees, Newman sent Gorelick a large box of documents responding to his demands. Joint Exh. 30. Numerous additional documents followed within days. Tr. 558, 953, 1075. Included were both the Helmsley and Rothenburg leases. Tr. 953. Gorelick and the Melrod firm thereafter made numerous requests for additional information. Tr. 559-560, 955, 1075, Joint Exhs. 31, 43, Plaintiff's Exh. 63.

After receiving these requests for voluminous information Newman spoke with Myerson. Tr. 564. Because of the nature of the requests Myerson and Newman called Gorelick and his partner, Louis Trotter ("Trotter"), on a conference call. Tr. 564-565. During the conversation Gorelick stated that everything on the list titled "Amendments Required to the Helmsley Lease", Plaintiff's Exh. 63, Joint Exh. 45, was absolutely essential to closing the loan. Tr. 565. Myerson told Gorelick and Trotter that many of their requests seemed unreasonable and unnecessary. Tr. 235. Nevertheless, Gorelick was willing to compromise on only one request, the "shoring up" provision for the building. Tr. 565-566. Under questioning at trial, however, Gorelick admitted that much of the information he requested was *not* essential for closing the deal, nor required by the Loan Commitment. Tr. 943-946, 963-969, 1103-1114.

On February 29, Myerson flew to Washington, D.C. for meetings with Dominion and the Melrod firm. PTO ¶ ¶ 32, 33. The only thing Gorelick would report at the time was that he had prepared a revised checklist and had sent it to Newman. Gorelick stated that it would therefore be useless to discuss anything further at that time. Tr. 237. Myerson then went to Dominion's offices and met with representatives of both Dominion and Community. Wienke stated that he believed there would necessarily be lengthy delays before the deal could close and gave Myerson a list, Joint Exh. 44, of items he felt he needed. Tr. 239-241. Community then decided to withdraw from the deal.

In another example of Gorelick's disregard for the oath he had taken to tell the truth, he denied at trial any awareness of Community's withdrawal from the deal until after this lawsuit began. His testimony is belied by oth-

ers. Gorelick and Neal had a conversation with Wienke on February 29, 1984, in which Wienke expressed Community's desire to withdraw from the deal. Tr. 986-987, 1122-1123, 1125-1126. Gavula stated that he informed Neal of Community's withdrawal on that date, Gavula Deposition, 48-49, and one of Gorelick's partners testified that Gorelick told him, before this litigation, that Community was withdrawing. Tr. 1374-1375. Community's withdrawal, however, was kept secret from Penthouse and Queen City.

Soon after his return Myerson received a letter from Bray requesting even more information. Joint Exh. 59. Myerson thereafter contacted Robert Guccione ("Guccione") President of Penthouse, who held a meeting at his home on March 6, 1984 which both Walde and Myerson attended. Tr. 18-19. Walde complained that Queen City was a small, inconsequential bank and ill-equipped to handle a transaction of this size. Tr. 19-20. Walde further stated that he wanted Queen City fired and Dominion to replace them as the lead bank. Tr. 20, 247-248. Although Walde expressly denied this, I do not believe him. Guccione responded that it would be fundamentally unfair and unethical to dismiss Queen City at this point in the deal, but that he would talk to Thomas Tracey ("Tracey") the Executive Vice President of Queen City and see if something could be done. Tr. 20-21, 248. Walde further told Guccione that he no longer had any concerns about Guccione's licensability. Tr. 22-23. Myerson also explained the plans for a management company to run the casino if there were any licensing problems. Tr. 248.

Guccione thereafter met with Tracey who was reluctant to give up Queen City's status as lead lender. Tr. 24, 26-27, 249-250.

On March 6, 1984 Guccione met with Walde, Gorelick and others of the Melrod firm in Washington, D.C. PTO ¶ 34. After lunch, Guccione and Walde met privately in Walde's office. Tr. 25-26. Guccione told Walde that Dominion could be a co-leader with Queen City and that he would pay Dominion for any fees they would lose by not being the exclusive lead lender. Tr. 26-28. Walde was not swayed by Guccione's observations that to remove Queen City from the deal would mean that Dominion would have to seek new participants for the over $60 million Queen City had already raised. Tr. 27-28, 248-249.

Throughout February and March, Dominion, through the Melrod firm, continued to make requests for more information which Newman accurately described as "never ending." Tr. 569. Dominion further demanded numerous changes in the way the entire deal was to be structured, the parties involved, and other changes not required by the Loan Commitment.

When Penthouse finally realized that Dominion was intentionally destroying the deal and would refuse to close, it sought to mitigate its damages by contacting Geiger and seeking a replacement for Dominion. Tr. 256-257. After numerous unsuccessful attempts to replace Dominion, Penthouse began seeking a buyer for the property. Tr. 257. Those efforts also failed. Penthouse now seeks damages from Dominion for breach of its participation agreement.

DISCUSSION

Plaintiffs allege that Dominion's conduct amounted to an anticipatory repudiation of the Loan Commitment. Defendants argue that their behavior does not rise to the level of an unequivocal refusal to perform their contractual obligations. They further argue that Penthouse

was not in a position to meet the conditions precedent to the loan closing, specifically conditions, 10, 11, 12, 13 and 16.

As to the defendant's latter assertion, at the time of the preclosing meeting, all of the conditions precedent had been met, waived, or were in a position to have been met by the date set for closing the loan. All the participants were aware, at the preclosing meeting, that there were some minor title problems which needed to be straightened out and discussions with the title company and Helmsley were ongoing. Tr. 294-297, 496-497, 548-552. There was no reason to believe this would not or could not be resolved prior to the actual closing. Penthouse indicated its willingness to go to Helmsley for the necessary changes, even though they expected it to cost them a considerable sum of money. Tr. 295-296.

Condition 10 required that the lender be furnished with copies of the utilities contracts prior to closing. Lipari, as counsel to the lender, had waived condition 10 regarding utilities by agreeing during the status conferences to proceed without obtaining new utilities agreements. Tr. 494. Conditions 11 and 12 were also waived by Lipari to the extent that they required documentation beyond that agreed to at the status conferences. Tr. 442-444, 491-493.

Condition 13 required that a project budget be in place prior to closing. A draft of the project budget had been prepared by the last status conference, Plaintiff's Exh. 17, and Bendesky testified that there was a project budget in place by the preclosing meeting. Tr. 444. Thus, condition 13 had been met.

Condition 16 required the lender's approval of the architect's contract, the contract with the project manager and the major trade contractors. This condition was also

waived by Lipari at the status conferences. Tr. 440-442, 492-493. Because these conditions had been met or waived, Dominion's argument to the contrary is totally unavailing.

While defendants are correct that merely threatening nonperformance under the contract would not rise to the level of an anticipatory breach, their conduct in this case far exceeded mere threats. Where a party to a contract indicates its refusal to perform unless entirely new or different conditions are first met, then it has breached the agreement. 4 Corbin on Contracts § 973 (1951); Restatement of the Law on Contracts § 250(b)(1981). New Jersey follows these basic contract principles.[3] *Ross Systems* v. *Linden Dari-Delite, Inc.*, 35 N.J. 329, 173 A.2d 258, 264 (N.J.Sup.Ct. 1961); *Seitz* v. *Mark-O-Lite Sign Contractors*, 210 N.J.Super. 646, 510 A.2d 319, 323 (N.J.Super Law Div.1986).

Defendant's pretense of willingness to proceed cannot mask its true intentions. Because of Community's withdrawal on February 29, Dominion was in the awkward position of having committed itself to lend more than the amount it was legally permitted to lend. While, as defendants argue, the mere commitment to lend in excess of this amount may not result in a violation of the Federal Home Loan Bank Board Regulations, it is nevertheless true, that actually lending the amount Dominion was committed to lend, would violate these regulations. Thus, Dominion either had to stall the closing until the loan expired and then withdraw from its commitment, or breach its agreement. In light of the circumstances, Dominion's representatives' conduct and statements

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[3] The parties do not dispute that New Jersey law applies in the instant case.

amounted to a clear refusal to proceed to closing unless conditions beyond those required by the Loan Commitment were first met.

For example, during February and March 1984 Gorelick stubbornly proclaimed that everything on the list titled "Amendments Required to Helmsley Lease" was absolutely required, yet, he was forced to acknowledge this was not in fact true during cross-examination. Tr. 943-946, 963-969, 1103-1114.

Among the documents signed November 21, 1983 was letter from John Beahan ("Beahan") of Queen City which Myerson accepted on behalf of Penthouse, amending the Commitment to require that a hotel management agreement be entered into within nine months of the loan closing. PTO Exh. D. In spite of this condition, Dominion insisted that the agreement be entered into prior to closing. Joint Exhs. 59, 61.

Although Penthouse had a long standing agreement with Sodeteg as the construction manager, and Queen City had approved its plans for obtaining subcontractors, tr. 440-441, 493-494, Dominion insisted that Penthouse hire Sigal Construction Company ("Sigal"). Tr. 122-124. Even if the imposition of post commitment conditions were appropriate, this particular one seems totally unreasonable and arbitrary. There is nothing to show that Sigal had any special expertise to recommend it as a builder or consultant for a major project other than a personal relationship between Sigal and the partners of the Melrod firm. Yet, Penthouse was advised that unless it acquiesced to these demands, Dominion would not close the loan. Tr. 33-38, 250-253, 1001.

Finally, Dominion insisted that it replace Queen City as the exclusive lead lender. Tr. 20-21, 27, 247-248. This

demand was made even though Dominion had no intention of doing anything with the loan except cheating plaintiffs out of the commitment fee.

Under the circumstances, such actions amounted to an unambiguous refusal to close by Dominion.

DAMAGES

Plaintiffs allege four categories of damages: (1) out of pocket expenses; (2) expenses for carrying and preserving the property; (3) loss of equity; and (4) loss of profits. In response, defendants argue only that Penthouse's alleged damages are speculative. I disagree.

It is axiomatic that a non-breaching party is entitled to be compensated for damages foreseeably arising from the breach of an agreement. Defendants do not dispute the amounts of, nor, assuming liability, plaintiffs' entitlement to compensation for its out of pocket expenses. To that end, Bendesky testified that Penthouse paid a total of $485,000 in commitment fees to the various participants and $255,000 in brokers fees to Geiger and Jefferson National. Tr. 444-447.

In addition, Penthouse paid $16,000 in appraisal fees; $14,920 for a market study; $10,500 in investigative costs; $205,631.87 to Sodeteg; $16,000 in architectural fees; and a total of $218,572.34 in attorneys' fees. Plaintiff's Exh. 23. Thus, plaintiffs' out of pocket expenses total $1,221,624.20 and they are entitled to receive payment for these damages.

Also, assuming liability, defendants do not dispute plaintiffs' entitlement to its second category of damages for carrying expenses.

Because there is no evidence contradicting plaintiffs' assertions that the time expended trying to find substitute financing, from June 1, 1984 through October 31, 1986, was reasonable, plaintiffs shall be awarded damages for this category as well. William Haggerty ("Haggerty") testified in his affidavit that during this period Penthouse spent a total of $16,599,248 on rent, real estate taxes, salaries, consultants, security, insurance, interest and other items necessary to preserve and carry the property. Haggerty Affidavit. Exh. D.

Plaintiffs' third and fourth categories of damages are somewhat difficult to reconcile. Plaintiffs claim a loss of equity in the property and argue they should receive damages consisting of the amount of their investment in the project less the fair market value of the property at the time of defendants' breach. Plaintiffs further request damages for lost profits. A loss of equity assumes a loss in value, while an especially profitable venture, more often than not, will increase in value. If the casino and hotel were profitable, obviously, there would be no loss of equity. Thus, I find it would not be appropriate to award damages for both a loss of equity and for lost profits.

Because the casino and hotel were never operational defendants argue that damages for lost profits are too speculative to calculate fairly or accurately. I disagree. In *Perma* v. *Singer Co.*, 542 F.2d 111 (2d Cir.1976) the Court of Appeals stated "the reasonable basis for damages that the law requires is a precise one, barring only those damages which 'are not the certain result of the wrong, not . . . those damages which are definitely attributable to the wrong and only uncertain in respect of their amount.'" *Perma* v. *Singer Co.*, 542 F.2d at 116 (quoting *Story Parchment Co.* v. *Paterson Parchment Paper Co.*, 282 U.S. 555, 562, 51 S.Ct. 248, 250, 75 L.Ed. 544 (1931)).

In the instant case it is abundantly clear that defendants' breach directly caused plaintiffs' loss of profits. Where that is the case, and the damages can be assessed with sufficient accuracy, plaintiffs are entitled to receive such damages.

Plaintiffs' expert witness, Peter Tyson ("Tyson"), testified that his estimates of lost profits were based in part on the profits made at other Atlantic City casinos and hotels. Tr. 682. Other factors, such as location and size, were also taken into account. Tr. 669-678. In his affidavit, taken as direct testimony, Tyson stated that the Penthouse casino and hotel would have earned $112,083,583 in profits over ten years if capitalized at a rate of 12%. Thus, plaintiffs are entitled to receive this amount in lost profits.

DOMINION'S CROSS-CLAIM

Finally, in light of the evidence presented at trial and my factual findings based on that evidence, Dominion's cross-claim against Queen City must fail. There is a total failure of proof that Queen City breached any duty owed to Dominion. In fact, the evidence shows just the opposite. Throughout the entire deal Queen City and Lipari acted responsibly and forthrightly by making every reasonable effort to close the loan. There is no evidence that Queen City breached any agreement, fiduciary duty, or that it acted negligently in any way.

QUEEN CITY'S COUNTERCLAIM

Queen City counterclaims against Dominion for breach of its obligations to Queen City. As a direct result of Dominion's failure to close the loan, Queen City claims to have suffered a loss of profits it otherwise would have earned. In one of the documents signed November 21, 1983 Dominion accepted the Queen City Commitment,

PTO Exh. B, and thus, Dominion's breach gives rise to claims by all parties to which it was contractually obligated. Having held that Dominion breached its agreement, I must also find it liable to Queen City for that breach.

In his affidavit, taken as direct testimony, Queen City's expert, Raymond Mitch ("Mitch"), calculated that Queen City's lost income amounted to $7,652,352.91. Defendants submit no evidence to contradict this amount. Because I find these damages were reasonably foreseeable, Queen City is entitled to recover the full amount.

In sum, judgment shall be entered for Penthouse in the amount of $129,904,455 and for Queen City in the amount of $7,652,352.91. Plaintiffs and the third-party defendant are directed to submit appropriate judgments within fifteen (15) days of the date of this Opinion on five (5) days' notice.

SO ORDERED.

United States Court of Appeals

FOR THE SECOND CIRCUIT

SDNY 84 Civ. 4325 DUFFY

Docket Nos. 87-9039, 87-9053

At a stated Term of the United States Court of Appeals for the Second Circuit, held at the United States Courthouse in the City of New York, on the twenty-sixth day of August one thousand nine hundred and eighty-eight.

Present: HON. THOMAS J. MESKILL
HON. FRANK X. ALTIMARI Circuit Judges
HON. JACOB MISHLER District Judge

PENTHOUSE INTERNATIONAL, LTD., and BOARDWALK PROPERTIES, INC.,
Plaintiffs-Appellees,

v.

DOMINION FEDERAL SAVINGS & LOAN ASSOCIATION, and MELROD, REDMAN & GARTLAN, P.C.,
Defendants-Appellants.

DOMINION FEDERAL SAVINGS & LOAN ASSOCIATION,
Third-party Plaintiff-Appellant,

v.

QUEEN CITY SAVINGS & LOAN ASSOCIATION,
Third-party Defendant-Appellee.

Filed Aug. 26, 1988

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK

This cause came on to be heard on the transcript of record from the United States District Court for the Southern District of New York, and was argued by counsel.

ON CONSIDERATION WHEREOF, it is now hereby ordered, adjudged and decreed that the Judgment of said District Court be and it hereby is reversed in part, affirmed in part and remanded to the said district court for further proceedings consistent with the opinion of this court.

Elaine B. Goldsmith, Clerk

/s/ Edward J. Guardaro
EDWARD J. GUARDARO, Deputy Clerk

Issued as Mandated Oct. 27, 1988

United States Court of Appeals

FOR THE SECOND CIRCUIT

Docket Nos. 87-9039, 87-9053

At a stated Term of the United States Court of Appeals for the Second Circuit, held at the United States Courthouse in the City of New York, on the thirteen day October one thousand nine hundred and eighty-eight.

PENTHOUSE INTERNATIONAL, LTD.,
and BOARDWALK PROPERTIES, INC.,
Plaintiffs-Appellees,

v.

DOMINION FEDERAL SAVINGS & LOAN ASSOCIATION, and
MELROD, REDMAN & GARTLAN, P.C.,
Defendants-Appellants.

DOMINION FEDERAL SAVINGS & LOAN ASSOCIATION,
Third-party Plaintiff-Appellant,

v.

QUEEN CITY SAVINGS & LOAN ASSOCIATION,
Third-party Defendant-Appellee.

Filed Oct. 13, 1988

A petition for rehearing containing a suggestion that the action be reheard in banc having been filed herein by appellees PENTHOUSE INTERNATIONAL, LTD., and BOARDWALK PROPERTIES, INC.,

Upon consideration by the panel that heard the appeal, it is

Ordered that said petition for rehearing is DENIED.

It is further noted that the suggestion for rehearing in banc has been transmitted to the judges of the court in regular active service and to any other judge that heard the appeal and that no such judge has requested that a vote be taken thereon.

Elaine B. Goldsmith, Clerk

/s/ Fred M. Cassidy
FRED M. CASSIDY, Deputy Clerk

QUEEN CITY SAVINGS

John E. Beahan
Senior Vice President

November 21, 1983

Dominion Federal Savings &
Loan Association
8301 Greensboro Drive
P.O. Box 929
McLean, Virginia 22101
Attn: David Neal
Vice President

RE: Penthouse Boardwalk Hotel
and Casino

Dear Mr. Neal:

With reference to our discussions concerning your acceptance of even date of a participation in the loan to Boardwalk Properties, Inc., Queen City Savings, hereinafter referred to as "Queen," is agreeable to Dominion Federal Savings, hereinafter referred to as "Dominion," being a co-lead Seller, under terms and conditions, as follows:

1. Dominion accepts the commitment of Queen, dated June 20, 1983, to Boardwalk Properties, Inc.

2. Dominion agrees to the Queen Loan Participation Sale and Trust Agreement, accepted by its participants to date. Regarding said Agreement, same shall be amended to include Dominion as a co-lead Seller; however, the administration of the Agreement together with all final approvals and decisions shall be rendered solely by Queen and its legal counsel, in their sole discretion, based upon discussions with Dominion, except for certain items provided for herein.

3. Queen and Dominion shall each have fifty (50%) percent of the non-interest bearing escrow accounts, for

real estate taxes and for payment of interest by Boardwalk Properties, Inc.

4. Queen shall be responsible for servicing the loan, pursuant to the Loan Participation Sale and Trust Agreement.

5. Dominion shall be permitted to solely maintain the operating checking account for the Project.

6. Queen agrees to Dominion's decision to appoint Harry A. Carroll, M.A.I., S.R.P.A., as the appraiser.

7. Queen agrees to Dominion's decision to require public liability insurance in the minimum amount of $2,000,000.00 to cover all claims for bodily injury and property damage arising out of a single occurrence.

8. In addition to Dominion receiving three-eights [sic] (3/8) of one (1%) percent commitment fee, during years six (6) through ten (10) of the mortgage loan, Queen shall give to Dominion one-eighth (1/8) of one (1%) percent of Dominion's participation amount during said years six (6) through ten (10) in consideration of Dominion's services as Co-Seller with Queen.

9. Queen and Dominion shall unanimously agree to the appropriate action to be taken with respect to the default portion of Article XII of said Loan Participation Sale and Trust Agreement.

In the event these terms and conditions are agreeable to you, kindly indicate your approval by signing the enclosed copy of this letter and return to me on or before November 23, 1983.

Very truly yours,

John E. Beahan

Dominion hereby accepts the above-named terms and conditions the 21st day of November, 1983.

/s/ David Neal
DAVID NEAL
Vice President

BOARDWALK PROPERTIES, INC.

November 21, 1983

Mr. James Winston Bray
Vice President
Dominion Federal Savings &
Loan Association
8301 Greensboro Drive
McLean, Virginia 22101

RE: Penthouse Boardwalk Hotel
and Casino

Dear Mr. Bray:

In consideration of Dominion Federal Savings & Loan Association ("Dominion") agreeing to participate, as a Co-Seller, in a certain $97,000,000 mortgage financing with Queen City Savings to Boardwalk Properties, Inc. ("BPI"), BPI agrees to pay to Dominion a yield adjustment fee of $125,000 on each anniversary of the loan closing date during the term of this loan. Further, BPI agrees to pay to Dominion one half (½) point ($175,000) on its $35,000,000 participation interest at the closing of this transaction.

Additionally, BPI agrees to pay Dominion's reasonable counsel fees incurred in connection with this transaction.

Very truly yours,

Boardwalk Properties, Inc.
/s/ David J. Myerson
DAVID J. MYERSON
Executive Vice President

QUEEN CITY SAVINGS

John E. Beahan
Senior Vice President

November 21, 1983

Boardwalk Properties, Inc.
1965 Broadway
New York, NY 10023-5965
Attn: David J. Myerson
Executive Vice President

RE: Queen City Savings —
Boardwalk Properties, Inc.

Dear Mr. Myerson:

We are pleased to advise that we have attained participation agreements with other institutions to make the $97,000,000 mortgage loan, satisfying the condition contained in paragraph 19 of the Conditions Prior to Loan Closing incorporated in our commitment to you dated June 20, 1983. Pursuant to our arrangements with our participants, we have set February 1, 1984 as the targeted closing date of this loan. Accordingly, it is requested that you fully cooperate with our counsel in order that this closing date be met.

It is a condition precedent to closing, that arrangements, reasonably satisfactory to us, shall have been made with the staff or the Casino Control Commission to permit the opening of the casino and hotel, upon completion of construction, utilizing a trustee or fiduciary in the event the license to Boardwalk Properties, Inc., its affiliates, or any of its principals has not been granted.

Sincerely,
/s/ John E. Beahan
JOHN E. BEAHAN
Senior Vice President

QUEEN CITY SAVINGS

John E. Beahan
Senior Vice President

November 21, 1983

Boardwalk Properties, Inc.
1965 Broadway
New York, NY 10023-5965
Attn: David J. Myerson
Excutive Vice President

RE: Commitment Extension

Dear Mr. Myerson:

This shall confirm our agreement to extend the date of our commitment to Boardwalk Properties, Inc., dated June 20, 1983, to December 1, 1983. All other terms and conditions set forth therein shall remain the same.

Kindly indicate your acceptance by signing the enclosed copy of this letter.

Very truly yours,
/s/ John E. Beahan
JOHN E. BEAHAN
Senior Vice President

Boardwalk Properties, Inc., hereby consents to the extension of the above commitment to December 1, 1983.

/s/ David J. Myerson
DAVID J. MYERSON
Executive Vice President

LIPARI, KEEFE & CHAMPI

November 21, 1983

Mr. Jay M. Newman
Lefrak, Fischer & Myerson
575 Madison Avenue
New York, New York 10022

RE: Queen City Savings
Boardwalk Properties, Inc.

Dear Jay:

With reference to our discussions and cursory review of the legal services required to close the mortgage loan of Queen City Savings to Boardwalk Properties Inc. pursuant to the commitment of Queen City Savings, dated June 20, 1983, to Boardwalk Properties Inc., it is agreed that we shall close this loan no earlier than February 1, 1984 or later than March 1, 1984.

I shall call you in a day or so to make arrangements to set up a temporary office in Atlantic City to work on this project.

I look forward to working with you on this matter.

Very truly yours,
/s/ John J. Lipari
JOHN J. LIPARI

DOMINION FEDERAL

February 6, 1984

HAND CARRIED

Mr. Robert A. Lewis
Vice President
First Jersey Savings & Loan Association
329 Main Street
Wyckoff, New Jersey 07481

Re: Penthouse Boardwalk Hotel and Casino
Atlantic City, New Jersey

Dear Mr. Lewis:

Dominion Federal Savings and Loan Association (Co-lender) with Queen City Savings (Lender) is pleased to offer to sell to First Jersey Savings & Loan Association (FJSL) a partcipating interest in Co-lender's interest in the first lien construction/permanent financing on the above referenced project subject to the following terms and conditions:

Borrower:

Boardwalk Properties, Inc., Atlantic City, New Jersey.

FJSL's Participating Amount:

FJSL's participating interest in the loan shall be $5,000,000.00.

Participating Interest:

FJSL's participating interest in the loan shall be the quotient of FJSL's participating amount, Five million dollars ($5,000,000.00), divided by the full loan amount, Ninety-seven million dollars ($97,000,000.00), which is approximately Five point fifteen (5.15%). FJSL's participating interest in Co-lender's interest in the loan shall be the quotient of FJSL's participating amount, Five million dollars ($5,000,000.00), divided by Co-lender's interest in the loan, Thirty-five million dollars ($35,000,000.00), which is fourteen point twenty-eight (14.28%) percent.

Net Yield to FJSL:
The net yield to FJSL shall be 14.125% per annum in years one through five, the first term, which includes the construction period. The net yield to FJSL shall be 14.625% per annum in years six through ten, the second term. These net yields are independent of all fees and servicing.

Term of Loan and Amortization:
Ten years, with the construction phase to be in effect for either (a) 24 months or (b) until the Borrower receives a certificate of occupancy from Atlantic City and the authority to operate the casino from the Casino Control Commission, whichever occurs first. During the construction phase, as previously defined, the loan shall consist of interest payments only paid monthly. At the termination of the construction phase, the loan shall begin to amortize over 300 months (25 years).

Fees:
A one-quarter percent (.25%) commitment fee is due and payable to FJSL upon your acceptance of this offer to sell and the Borrower's acceptance of the financing.

A one percent (1.0%) fee is due and payable to FJSL fifteen (15) days after the loan closing.

Additionally, there shall be a fee of one-quarter of one percent (.25%) of the original participation amount due and payable to FJSL fifteen (15) days after each of the closing anniversary years of the second term of the loan, namely, years six (6), seven (7), eight (8) and nine (9).

Security:
The Penthouse Boardwalk Hotel/Casino, located at Missouri Avenue and the Boardwalk in Atlantic City, New Jersey, which shall ultimately consist of 515 hotel rooms and a 48,000-square-foot casino. The security, hereinafter collectively referred to as the "Mortgage," shall include:

A. A note made and delivered by Borrower secured by a valid first mortgage lien on all real estate owned by Borrower covering the project site together with all improvements on and to said real estate.

B. A valid first leasehold interest in and to the Lease between Borrower and Albert Rothenberg and Robert Rothenberg for the Four Seasons Hotel located on Block 38, Lot 1, including a first mortgage covering the improvements thereon. There shall be an Assignment of said Lease to Lender, consented to by the Landlord, at closing, to be effective in the event of Borrower's default of the terms and conditions of this loan.

Borrower shall certify there are no violations of said Lease at closing.

C. A valid first leasehold interest in and to the Lease between Borrower and Boardwalk and Missouri Corp. for the Holiday Inn located in Block 38, Lots 3, 4, 75 and 86, including a first mortgage covering the improvements thereon. There shall be an Assignment of said Lease to Lender, consented to by the Landlord, at closing, to be effective in the event of default by Borrower of the terms and conditions of this loan. Also, in the event Borrower is not in default with Lender, it nevertheless shall give Lender its option to purchase the property, as set forth in said Lease, provided Borrower declines or is unable to exercise its option to purchase the property. Borrower must give Lender at least sixty (60) days written notice prior to the latest timely notice required to be given to Landlord for acquiring title to the property during the January 1, 1987 and February 28, 1988 period.

Borrower shall cause the current lessees of the four retail stores, covered by a lease with the Land-

lord, to be removed and replaced by tenants in accordance with the plans and specifications prior to the commencement of construction.

Interest Reserve Account:
During the term for payment of interest only, as aforesaid, same shall be automatically withdrawn and paid from a non-interest bearing account which shall contain sufficient monies to cover a maximum of two months interest payments, said account to be funded from the principal balance of the loan or the construction loan advances, at the sole discretion of the Lender. Any and all monies remaining in said account at the time of amortization shall be relinquished and returned to Borrower.

Guarantors:
Boardwalk Properties, Inc., Penthouse International, and Mr. Robert Guccione personally. Certification will be required by Boardwalk Properties, Inc. and Penthouse International that their total combined investment in the subject project is at least $60,000,000.00 at this time. Penthouse International shall furnish, at closing, satisfactory proof that all of its portion of the present investment in Boardwalk Properties, Inc. is in fact a loan to Borrower and an account receivable of Penthouse International, Ltd. Penthouse International shall assign said loan and account receivable to Lender in a manner and form satisfactory to Lender's attorney such that Lender shall have a first right thereto in case of any payment(s) made by Borrower on account of same.

Prepayment and Cancellation:
In the event the loan is prepaid at any time within the first six years, there shall be a prepayment penalty of two and one-half percent (2.5%) of the original amount of the loan. Thereafter, during years seven through ten, the prepayment penalty shall decline by one-half of one percent (.5%) annually, namely, a penalty of 2% in year seven,

1.5% in year eight, 1% in year nine, and .5% in year ten.

Additionally, there shall be a cancellation fee of one-half percent (.5%) payable upon payment and cancellation of the loan at any time the loan is paid.

Trustee:
If subsequent to closing, the Casino Control Commission will not issue a permit to operate to Boardwalk Properties, Inc., Penthouse International, or Robert Guccione, then said corporation(s) or individual will transfer its or his respective right, title and interest to a trustee approved by the Commission.

Legal Counsel:
Legal counsel for the Borrower shall be Lipari, Keefe & Champi (John J. Lipari, Esquire), 5 North Avenue, Cranford, New Jersey 07016, who shall be responsible for procuring the title search and a policy of title insurance from an acceptable insurance carrier; the preparation and recording of all legal documents in connection with the loan; the review and approval of all documents required to be submitted by Borrower or its counsel, including leases, assignments, surveys, plans, specifications, and any and all other items of a legal nature required in connection with this loan. All of the aforesaid counsel's costs and expenses shall be paid by the Borrower at closing.

Legal counsel for Co-lender shall be Taylor & Stauffer, 8300 Greensboro Drive, McLean, Virginia 22102.

Borrower's Warranties:
Borrower, as a material inducement to make the loan, represents and warrants that:

A. There is no litigation pending or threatened which could in any way affect any of the following: title to the property or any part thereof; the validity or priority of the lien of the Mortgage; the validity and non-violation of the Leases; the issuance or validity of any zoning variances or other zoning or subdivi-

sion approvals affecting the property; any building permits or other governmental permits which have been or are to be issued with respect to the property.

B. The final plans and specifications for the erection of the Improvements (to be approved by Lender) will have been approved by all appropriate state and local governmental authorities, and upon completion the property will comply in all respects with all requirements of local, state and federal regulations and laws, including those relating to building, zoning, subdivision, and environmental protection.

C. Water and sewer service supplied by municipal or quasi-municipal authorities, and other necessary utilities, such as electricity, telephone service and gas (if included in any plans) are available to service the full needs of the property, and valid and enforceable agreements to supply such services have been entered into with the supplier thereof.

The foregoing warranties shall be restated and shall be true and correct at the time of closing and throughout the term of the loan.

Additional Conditions:
The Conditions Prior to Closing attached hereto are hereby made a part of this commitment letter. The obligation to close the loan is contingent upon the satisfaction of each of said conditions.

Servicing:
Servicing of this loan is to be performed by Queen City Savings under the terms and conditions specified in a mutually acceptable servicing agreement. Co-lender shall remit FJSL's payments within ten (10) days after Co-lender's receipt of its remittance.

Loan Funding:
The initial funding for the loan is anticipated to occur in February or March of 1984. Upon Servicer's notice of a funding request to Co-lender, Co-lender shall notify FJSL of FJSL's funding as represented by FJSL's 14.28% participation of Co-lender's interest in the loan.

Waiver:
This commitment embodies the entire agreement between the parties, and any waiver or modification of the terms and conditions hereof by us must be in writing and signed by a duly authorized officer of Co-lender.

Acceptance:
If the terms and conditions of this offer meet with your acceptance, please acknowledge this letter by signing in the space provided below and returning to the undersigned. It is the intention of Co-lender to sell this participation interest to the first acceptor of our offer. We will notify you immediately upon our receipt of your acceptance.

Sincerely,
/s/ Timothy J. Bolger
TIMOTHY J. BOLGER, C.F.A.
Vice President

Receipt and acceptance is hereby acknowledged:
FIRST JERSEY SAVINGS LOAN ASSOCIATION

By: _____ Date: _____

Supreme Court, U.S.
FILED
FEB 10 1989
JOSEPH F. SPANIOL, JR.
CLERK

No. 88-1144

IN THE
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1988

PENTHOUSE INTERNATIONAL, LTD. and
BOARDWALK PROPERTIES, INC.

Petitioners,

v.

DOMINION FEDERAL SAVINGS & LOAN ASSOCIATION,
MELROD, REDMAN & GARTLAN, P.C., AND
QUEEN CITY SAVINGS & LOAN ASSOCIATION,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR RESPONDENTS DOMINION FEDERAL SAVINGS & LOAN ASSOCIATION AND MELROD, REDMAN & GARTLAN, P.C., IN OPPOSITION

PAUL, WEISS, RIFKIND,
WHARTON & GARRISON
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(212) 490-0700

Attorneys for Respondent
DOMINION FEDERAL SAVINGS & LOAN ASSOCIATION

KRAMER LEVIN NESSEN
KAMEN & FRANKEL
919 Third Avenue
New York, New York 10022

Attorneys for Respondent
MELROD, REDMAN & GARTLAN, P.C.

QUESTION PRESENTED

Whether the court of appeals erred in this diversity case when it undertook a careful review of a voluminous trial record, determined, pursuant to Rule 52(a) of the Federal Rules of Civil Procedure, that material findings of fact by the district court were "clearly erroneous" and applied unexceptional doctrines of New Jersey law to undisputed facts.

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IN THE
SUPREME COURT OF THE UNITED STATES
October Term, 1988
No. 88-1144

PENTHOUSE INTERNATIONAL, LTD. and
BOARDWALK PROPERTIES, INC.,

Petitioners,

-against-

DOMINION FEDERAL SAVINGS & LOAN
ASSOCIATION, MELROD, REDMAN &
GARTLAN, P.C., and QUEEN CITY
SAVINGS & LOAN ASSOCIATION,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO
THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

BRIEF FOR RESPONDENTS DOMINION FEDERAL SAVINGS & LOAN ASSOCIATION AND MELROD, REDMAN & GARTLAN, P.C., IN OPPOSITION

Respondents Dominion Federal Savings & Loan Association ("Dominion") and Melrod, Redman & Gartlan, P.C. (the "Melrod firm") submit this joint brief in opposition to the petition for a writ of certiorari filed by petitioners Penthouse International, Ltd. and Boardwalk Properties, Inc. (collectively "Penthouse").

STATEMENT OF THE CASE

This case is a routine diversity suit for breach of contract, governed by New Jersey law. It attracted the media attention stressed by petitioners only because the district court, relying on discredited precedent, imposed a hugely inflated "lost profits" damage award.[1/] It caused a stir in the lending industry because the district court, venting indignation and anger over what it believed to be an intentional breach of a business contract, expressed its findings in unusually harsh language (*see, e.g.*, A. 64a, 77a, 80a, 81a, 88a).[2/] And it drew an *amicus curiae* brief from the Federal Home Loan Bank Board favoring respondents' position only because the district court's holding that the lead lender could waive Penthouse's compliance with several material pre-closing conditions threatened to change radically the ground rules for syndicated lending in the United States.

Although the petition for certiorari (pp. 12–14) stresses the media attention given to the proceedings below, it does not rely upon any of the normal factors warranting certiorari: it presents no issue of federal law; it cites no conflict among the courts of appeals; it suggests no important question of unsettled law of any kind. Rather, the petition invokes only this Court's "supervisory authority" over the lower federal courts (Cert. Pet. at 12), merely to correct an asserted oversight in the application of New Jersey law and to reconsider fact findings determined to have been clearly erroneous.

Even if there were errors in either respect, this would not be an occasion for the exercise of this Court's "supervisory power." In

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1/ As the court of appeals observed (Pet., App. 45a), the district court's award of lost future profits — by far the lion's share of its $128.6 million judgment — was erroneously premised on the Second Circuit's 1976 decision in *Perma Research & Development Co.* v. *Singer Co.*, 542 F.2d 111 (2d Cir.), *cert. denied*, 429 U.S. 987 (1976), decided under New York law. That case enunciated a rule of damages that was rejected by the New York Court of Appeals in *Kenford Co.* v. *County of Erie*, 67 N.Y.2d 257, 493 N.E.2d 234, 502 N.Y.S.2d 131 (1986).

2/ Citations preceded by the prefix "A. ____" refer to pages of the appendix to the Petition for a Writ of Certiorari; citations bearing the prefix "J.A. ____" refer to pages of the joint appendix in the court of appeals.

any event, there was no misapplication of New Jersey law, and the court of appeals, far from trampling upon the district court's domain, stayed well within the "clearly erroneous" standard of Rule 52(a), F.R. Civ. P. The court of appeals carefully avoided resolving the credibility questions which had so disturbed the district court. 3/ Instead, it undertook a careful review of the trial record and found clear error on the basis of unambiguous documentary evidence and facts in the record on which there was no dispute. In short, applying settled principles of New Jersey law, the court of appeals held that Penthouse had failed to prove its case.

* * *

As the petition for certiorari recognizes (at 14–15) there were two separate grounds for the court of appeals' holding that the anticipatory breach finding was "clearly erroneous": (1) that Penthouse had failed to meet its burden of proving its ability to satisfy essential preconditions embodied in the written contract (A. 45a); and (2) that almost all of the acts and utterances of Dominion and its lawyers (the Melrod firm) relied upon by the district court as evidence of "anticipatory breach" took place after the contractual loan commitment had expired (A. 33a). The court of appeals made clear that these were two separate and independent grounds for reversal (A. 45a). We therefore turn to the record facts relevant to those two separate grounds.

3/ Even the first-time reader of the district court's extraordinary opinion (A. 67a–91a) and supplementary order (A. 62a–64a) must be struck by the extent to which the district judge was driven by his personal reaction to the witness-stand demeanor of Melrod partner Philip Gorelick and, to a lesser extent, Dominion's Chairman William Walde. The district court's upset was first revealed in the remarkable "robing room incident" recounted in the court of appeals' opinion (A. 22a) — in which the district court *ex parte* expressed its view that Gorelick was lying, while he was still on the stand; it emerged full-blown in the district judge's graphic description of Gorelick's subsequent discomfort under cross-examination (A. 77a n.1); and it culminated in his *sua sponte* imposition of the full $128.6 million damage award upon the Melrod firm, even though Penthouse had sought a judgment of only $1.2 million against that firm (A. 62a–64a). Although they were not essential to the grounds for its reversal, the court of appeals felt constrained to express its strong disapproval of these excesses by the district court (A. 54a).

The Penthouse Loan Commitment

The statement of facts in the petition for certiorari (at 2-9) glosses over the terms of the basic written contract which the district court held that Dominion breached. That contract was the loan commitment letter between Penthouse and respondent Queen City Savings & Loan Association ("Queen City"), dated June 20, 1983 (J.A. 85-96). Pursuant to the loan commitment, Queen City agreed to be the "Lender" on a secured $97 million construction loan, but obligated itself to lend only $7 million — less than 8% of the total loan. Queen City's $97 million commitment was expressly conditioned on obtaining "other lenders" to participate for the remaining $90 million, through Queen City as "lead institution." [4/]

When Dominion became the last participant on November 21, 1983, the documents it signed expressly incorporated the Penthouse-Queen City loan commitment as the essence of Dominion's contractual obligation (A. 9a).

The Written Pre-Closing Conditions

The loan commitment to which Dominion agreed enumerated twenty "Conditions Prior to Loan Closing." Thus, prior to the lenders having any obligation to close, Penthouse was required, *inter alia*, to obtain clean title on certain leaseholds, so as to be able to deliver the promised first mortgage liens (A. 6a); it was obligated to arrange with the New Jersey Casino Control Commission for a license (or an acceptable alternative arrangement) permitting the operation of

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4 Although Queen City is named as a respondent in the petition for certiorari, Penthouse did not sue Queen City. It became a party when Dominion asserted a third-party claim against it for breach of its duties to Dominion. Queen City then counterclaimed against Dominion. The district court dismissed the third-party claim, but awarded Queen City $7.6 million on its counterclaim. Because the court of appeals reversed both Penthouse's judgment against Dominion and Queen city's judgment on its counterclaim, it also affirmed the dismissal of Dominion's third-party indemnification claim. Accordingly, solely as a protective measure, Dominion is filing a conditional cross-petition for certiorari seeking review of the dismissal of its third-party claim against Queen City.

a casino on the premises (A. 9a–10a); and it had to have in place final plans and specifications for its proposed casino–hotel, contracts with major trade contractors and utilities, and a final budget detailing how the borrowed funds would be spent (A. 6a–7a).

There was nothing remarkable about these pre–closing conditions — they were designed to give the lenders assurance that they would have a clean, insurable first lien on a casino–hotel licensed to operate, and that the $97 million loan would be sufficient for Penthouse to complete the construction. Nevertheless, as the court of appeals recognized, there was no evidence in the voluminous trial record that Penthouse ever met, or was even close to meeting, these material pre–closing conditions (A. 45a).

The most that appears in the record on the clean title condition is that Penthouse had recognized the necessity of obtaining amendments to certain leases in order to be in a position to deliver clean title, and had asked its New Jersey lawyer to make contact with a representative of the lessor (A. 42a–44a). Likewise, on the casino licensing condition, the record shows only that another New Jersey lawyer for Penthouse had begun discussions with the staff of the New Jersey Casino Control Commission, which had resulted only in a "rough outline" of what the lawyer thought "might be acceptable" to the Commission (A. 44a). And with respect to the requirements for final plans and specifications, trade contracts and utilities, Penthouse did not even attempt to prove its compliance; rather, it relied upon oral statements in January 1984 by John Lipari, Queen City's lawyer, purporting to accept non–compliance with those conditions — what Penthouse now calls "substitute performance," but the district court held to have been "waivers" of those conditions (A. 85a–86a). There was no evidence that Dominion was ever consulted about, much less consented to, such "waivers." Nor was there any evidence, as the court of appeals held, that Queen City was given authority to bind Dominion to such "waivers."

Dominion's Alleged "Anticipatory Breach"

The district court premised its finding that Dominion was guilty of "anticipatory breach" of the loan commitment on the following actions and utterances of Dominion and its attorney, Philip Gorelick of the Melrod firm: (1) that Gorelick had insisted on re-doing the loan documentation and on obtaining proposed lease amendments that went beyond what was required to deliver clear title; (2) that Dominion had demanded that a hotel management agreement be in place prior to closing; (3) that Dominion, through Gorelick, had urged that Penthouse hire a construction company to perform a cost evaluation; and (4) that Dominion had demanded that it replace Queen City as lead lender.

All but the first of these actions took place after March 1, 1984 — and the court of appeals held that the district court erred by taking them into account in determining anticipatory breach because the loan commitment had expired on that date (A. 32a). 5/ The court of appeals' holding that the written loan commitment expired on March 1 was, in turn, based upon the following documentary evidence and undisputed facts in the record:

(a) On its face, the loan commitment was an agreement that its drafters did not intend to be open-ended; rather, it contained a definite expiration date that could not be extended except in writing (A. 28a).

(b) The only writings purporting to extend the expiration date were two letters dated November 21, 1983 which extended that date to December 1, 1983, but also set a closing date of no later than March 1, 1984 (A. 27a).

5/ With regard to the remaining ground for the "anticipatory breach" holding — that Gorelick had insisted on re-doing the closing documents and allegedly required unnecessary amendments to the lease — the court of appeals reviewed the entire record and concluded that the district court had "clearly erred" in holding that such requests gave rise to an anticipatory breach under New Jersey law (A. 34a-36a).

(c) In paragraph 7 of its complaint, Penthouse had alleged *as fact* that

> "[t]he Loan Commitment was scheduled by its terms, to remain in effect for 120 days after issuance, and *was subsequently extended to March 1, 1984.*" (Emphasis added.)

(d) The district court had itself implicitly found a March 1, 1984 deadline when it concluded that the title problems "could have been resolved in time to close the deal before March 1, 1984" (A. 74a). (Although not expressly cited by the court of appeals, the district court's finding of a definite expiration date was also implicit in its conclusion that Dominion had determined "either . . . to stall the closing *until the loan expired* and then withdraw its commitment, or breach its agreement." (A. 86a; emphasis added.))

The Opinions Below

1. *Penthouse's Ability to Perform*

The district court's basic findings on this issue were as follows:

> . . . at the time of the preclosing meeting [Feb. 9, 1984], all of the conditions precedent had been met, waived, or were in a position to have been met by the date set for closing the loan. . . . [T]here were some minor title problems which needed to be straightened out . . . [but t]here was no reason to believe this would not or could not be resolved prior to the actual closing. [A. 85a.]

The court of appeals, noting that Penthouse "bore the burden of establishing its willingness and ability to perform all of the obligations under the agreement," concluded that these findings were clearly erroneous (A. 36a–45a). Considering the *undisputed* evidence concerning Penthouse's problems in obtaining insurable title (A. 43a–44a), the court of appeals was

> compelled to conclude that the district court clearly erred when it characterized these matters as being "minor." Unless

these problems were resolved, they absolutely would have prevented Penthouse from delivering the title required in the commitment. Likewise, unless the Helmsley lease was modified, Penthouse could not certify that there were "no violations" of that lease. Thus, in view of the gravity of these problems, Penthouse knew that they had to be resolved by the closing date. We therefore conclude that they were not "minor." [A. 42a–43a]

Similarly, with regard to Penthouse's inability to obtain a casino license, the court of appeals wrote:

> With regard to the [district] court's finding concerning the status of the alternative licensing arrangements condition, we note that the district court overlooked the fact that this was a *preclosing* condition. Because the court found that these arrangements could have been made *after* closing, it is clear that Penthouse did not carry its burden to demonstrate its ability to perform this condition *before* closing. In addition, we observe that record evidence does not support the court's finding that these arrangements were "easily within reach.". . . Therefore, due to the tentative status of the proposed alternative arrangements and the absence of an actual agreement, we are convinced that the district court also erred in this regard. [A. 44a]

As the court of appeals clearly understood (A. 38a), the district court's finding that Penthouse did not have to prove its ability to comply with other pre-closing conditions (*i.e.*, final plans and specifications, trade and utility agreements, and a final budget), because they were "waived" by Queen City, was integral to its determination that Penthouse had met its burden of proof. The court of appeals concluded that the district court's "waiver" finding was also clearly erroneous, because

> it is clear that Queen City was not authorized expressly or inferentially in the commitment or the participation agreement to modify the terms of the commitment by waiving Penthouse's full compliance with preclosing conditions. [A. 40a]

In reaching this result, the court of appeals did not rely on disputed testimony requiring an assessment of credibility — because

Penthouse presented no testimony on Queen City's authority to waive pre-closing conditions. Rather, it construed the clear language of contract documents, including the following:

(a) The documents signed by Dominion incorporated the terms and conditions of both the loan commitment and a separate participation agreement among the lenders, requiring the court to read the documents together as one instrument under New Jersey law. (A. 39a.) [6/]

(b) Nowhere did the loan commitment or participation agreement provide that Queen City was authorized by the participating lenders to waive Penthouse's compliance with any of the preclosing conditions (A. 39a).

(c) While the loan commitment provided that

> [a]ll title questions and all other legal matters relating to or arising out of the Loan shall be subject in all respects to the approval of the Lender's counsel. . . and the decision of the Lender's counsel as to whether all conditions of the commitment have been met shall be final,

it also provided that

> [l]ender's obligation to close the loan is contingent upon the satisfaction of each of [the pre-closing] conditions. [A. 39a]

Reading these provisions together, the court of appeals concluded that

> . . . although Queen City had the final word on whether the preclosing conditions had been satisfied, Penthouse nevertheless was required to satisfy each of the preclosing conditions. Thus, Queen City was granted essentially administrative authority to oversee the manner in which the preclosing conditions were satisfied, but it was not empowered to waive Penthouse's compliance with the preclosing conditions. (A. 39a–40a)

6/ *Schlein* v. *Gairoard*, 127 N.J.L. 358, 360, 22 A.2d 539, 540–41 (1941); *see Schlossman's, Inc.* v. *Radcliffe*, 3 N.J. 430, 435, 70 A.2d 493, 495 (1950).

(d) The participation agreement expressly provided that its terms could not be modified except by an agreement in writing.

(e) The participation agreement authorized Queen City to act on behalf of the lenders in the capacity of an independent contractor, not as an agent. Under New Jersey law, therefore, Queen City had discretionary power as to the means and manner of contractual performance, but it was not empowered to make material changes that rendered the participants less secure (A. 40a). 7/

Penthouse itself recognizes that such judicial construction of unambiguous contract documents is appropriate for an appellate court (Cert. Pet. at 23). Beyond the contractual language, there was no evidence in the record to suggest any implied grant of power to Queen City to waive the pre-closing conditions. Indeed, all the evidence was to the contrary (A. 41a).

2. *Dominion's Alleged "Anticipatory Breach"*

The court of appeals had no difficulty in determining, as a matter of law, that the loan commitment expired on March 1, 1984. Penthouse had so alleged in its complaint (¶ 7), and -- contrary to Penthouse's assertion (Cert. Pet. at 20) that the district court made no findings to this effect -- a March 1 expiration was implicit in at least two of the district court's own findings (*see* p. 7 *supra*). Beyond that, the written agreements permitted no other conclusion (*see* pp. 6-7 *supra*) and there was evidence in the record that Dominion, as well as other participants, believed in 1984 that their commitments had expired on March 1 (J.A. 2316-20). The court of appeals thus concluded that

> [t]he parties bargained for a loan commitment that remained open only for a stated duration and we are not at liberty to construe that agreement in a manner inconsistent with its clear language. [A. 30a.]

7/ *See, e.g., Errickson* v. *F.W. Schwiers, Jr. Co.*, 108 N.J.L. 481, 483, 158 A. 482, 483 (1932); Restatement (Second) of Agency § 51 comment c (2d ed. 1979).

Applying settled New Jersey law in light of the March 1 expiration date, the court of appeals held that Dominion's conduct after March 1, 1984 was not relevant to the determination of whether an anticipatory breach had occurred. And in a determination the petition does not challenge, the court of appeals concluded that the district court "clearly erred" when it found an anticipatory breach based on Dominion's conduct prior to that date (A. 35a–36a).

Because it concluded that the district court's findings concerning *both* Penthouse's ability to perform *and* Dominion's anticipatory breach were "clearly erroneous," the court of appeals unanimously reversed the judgment against Dominion. 8/

REASONS FOR DENYING THE WRIT

I.

The Decision Of The Court Below Presents No Question of General Importance Warranting Review By This Court

As noted at the outset, Penthouse's petition for certiorari does not raise any federal question, or assert a conflict among the circuits, or seek resolution of any unsettled issue of law. Rather, Penthouse invokes only this Court's "supervisory power," claiming that it should be utilized simply to correct an asserted misapplication of settled New Jersey law and alleged appellate fact-finding in violation of Rule 52(a), F.R. Civ. P. But, as this Court has affirmed, "[t]he supervisory power is applied with some caution," *United States* v. *Payner*, 447 U.S. 727, 734 (1980), and is used only rarely. It is used, for example, to establish and maintain "civilized standards of procedure and evidence" in criminal cases, *McNabb* v. *United States*, 318 U.S. 332, 340 (1943), or "in the determination of the procedures to be employed by

8/ The judgment against the Melrod firm was also reversed. Among other things, the court concluded that there was no evidentiary basis for the fraud claim against the Melrod firm (A. 50a–54a) and that the finding of "perjury" by Gorelick was both unnecessary and not, as required, based upon "clear and convincing proof" (A. 54a). Penthouse does not seek review of this part of the court of appeals' decision.

courts to enforce their orders, a subject that directly concerns the functioning of the judiciary." *Young* v. *United States ex. rel. Vuitton et Fils S.A.*, 107 S. Ct. 2124, 2138 (1987). Penthouse cites no authority even hinting that it is appropriate for this Court to supervise the circuit courts' application of settled state contract law, or to review every asserted transgression of Rule 52(a).

Although Penthouse argues that the court of appeals purported to "fashion general commercial law" in violation of *Erie R. Co.* v. *Tompkins*, 304 U.S. 64 (1938), in fact the petition presents nothing more than a claimed failure to consider one unremarkable line of New Jersey authority on the "time of the essence" doctrine (Cert. Pet. at 14–16). Even were that an error under New Jersey law (which it was not, see pp. 13-14 *infra*), it would be no occasion for exercise of "supervisory power" by this Court. That much is obvious simply from comparing this case to *Exxon Co., U.S.A.* v. *Banque de Paris et des Pays–Bas*, 109 S. Ct. 299 (1988), cited by Penthouse, in which this Court summarily remanded to the Fifth Circuit for consideration of a new Texas case decided after the court of appeals decision. Here, there is no claim of any intervening change in New Jersey law since the date of the court of appeals decision. Rather, as Penthouse itself states (Cert. Pet. at 15), the "time of the essence" doctrine allegedly "overlooked" was "fundamental and well–established" in New Jersey years ago.

The petition thus flies in the face of the settled principle that this Court does not sit to review determinations of state law by the courts of appeals. As this Court stated in *Haring* v. *Procise*, 462 U.S. 306, 314 n.8 (1983), "standing alone, a challenge to state–law determinations by the court of appeals will rarely constitute an appropriate subject of this Court's review."

Judged by these familiar standards, the petition for certiorari presents no problem of applying state law that requires review by this Court.

II.
The Court of Appeals Correctly Applied New Jersey Law in Any Event

Penthouse does not claim that the court of appeals ignored New Jersey law in reaching its determinations. On the contrary, the Second Circuit cited unimpeachable New Jersey authority throughout its opinion (*e.g.*, A. 27a–28a, 31a, 32a, 36a, 39a) and applied principles of contract law that are unassailable in New Jersey and probably good law in every state (*e.g.*, A. 27a, 31a, 32a, 37a).

Penthouse's sole quarrel with the court of appeals' application of New Jersey law is its claim that the court's holding that the commitment expired on March 1, 1984 overlooked the "time of the essence" rule enunciated in *Selective Builders, Inc.* v. *Hudson City Savings Bank*, 137 N.J. Super. 500, 349 A.2d 564 (N.J. Super. Ct. Ch. Div. 1975), and other cases. The contention is without substance.

To begin with, this Court should not even consider the "time of essence" argument now advanced by Penthouse because it was not asserted in the court below. *See, e.g., United States* v. *Ortiz*, 422 U.S. 891, 898 (1975); *Virtue* v. *Creamery Package Manufacturing Co.*, 227 U.S. 8, 38 (1913). Although Penthouse expressly devoted a section of its Second Circuit brief (p. 54) to the March 1 expiration issue, and even cited *Selective Builders* in that connection, contrary to the suggestion in its petition (p. 16), Penthouse made no mention whatever of the "time of the essence" doctrine before the court below. Accordingly, it cannot raise that argument for the first time before this Court.

In any event, the "time of the essence" argument based on *Selective Builders* is without merit. To be sure, *Selective Builders* held that even if time is of the essence, expiration dates in written contracts can be waived or extended. But that same case went on to make clear that any such waiver or extension "must take the form of an agreement founded on valuable consideration" *or* "*a clear, unequivocal* and *decisive* act showing such purpose as to amount to estoppel *in pais*." (137 N.J. Super at 505 n.3, 349 A.2d at 567 n.3; emphasis added.)

In this case, there was no evidence to support a finding that the March 1 deadline date was mutually extended or waived by either an agreement founded on valuable consideration or any "clear, unequivocal and decisive" act by Dominion. On the contrary, Penthouse asserts -- and the district court found — Dominion's acts after March 1 to be evidence of an "unambiguous refusal to close" (A. 88a), not an "unequivocal and decisive" extension of the commitment.

There is another fundamental distinction between this case and *Selective Builders*. There, the borrower had already complied substantially with the preconditions of the contract — indeed, "the project was at least 95% finished at the time in question and thus substantially completed" (*Id.* at 504, 349 A.2d at 567). The New Jersey court thus declined to permit the lender to use the contractual expiration date as the sole excuse for its refusal to perform. Here, the record is clear that, on March 1, 1984, Penthouse was nowhere near ready to close. Moreover, unlike *Selective Builders*, the expiration date was not relied upon as Dominion's excuse for not closing. The court of appeals did not hold, as Penthouse argues (Cert. Pet. at 15), that the instant a written time limit is allowed to expire, "the lenders are thereby relieved of any further legal obligations to the borrower." All it did was to correct the district court's erroneous reliance on acts by Dominion and its counsel after March 1 as supposed evidence of "anticipatory breach." The court of appeals quite understandably declined to consider Dominion's actions after March 1 as evidence of *both* an unequivocal agreement to extend the expiration date *and* an unambiguous refusal to close the loan. No New Jersey case has ever applied the "time of the essence" doctrine in that manner, to whipsaw a contracting party into huge damages for an "anticipatory breach" after the contractual expiration date.

In short, the court of appeals did not err in its application of New Jersey law.

III

The Court of Appeals Scrupulously Observed the Standards of F.R. Civ. P. 52(a)

There was no disregard of the review standards of F.R. Civ. P. 52(a). Although the petition accuses the court of appeals of "deciding factual issues," it can point to no instance in which the appellate court usurped the trial court's prerogative to "judge the credibility of witnesses" [9/] or where it set aside findings of fact except when it found them to be "clearly erroneous." The court of appeals adhered scrupulously to the "clearly erroneous" standard, applying it *in haec verba* no fewer than nine times in its opinion, and carefully explaining each application. The decision below thus stands in sharp contrast to *Dennison Manufacturing Co.* v. *Panduit Corp.*, 475 U.S. 809, 811 (1986), cited by Penthouse, in which this Court vacated and remanded to the court of appeals "for further consideration in light of Rule 52(a)," because the opinion below "did not mention Rule 52(a), did not explicitly apply the clearly-erroneous standard to any of the District Court's findings . . . and did not explain why, if it was of that view, Rule 52(a) had no applicability . . . ."

What Penthouse portrays as impermissible "fact-finding" by the court of appeals was in fact a meticulous review of the documentary and undisputed facts in the record, leading to a "definite and firm conviction that a mistake [was] committed," *United States* v. *United States Gypsum Co.*, 333 U.S. 364, 395 (1948). Unlike *Icicle Seafoods, Inc.* v. *Worthington*, 475 U.S. 709 (1986), cited by Penthouse, where this Court's ruling was based on the fact that "nowhere in its opinion did the court [of appeals] ever mention any of the factual findings of the District Court, much less discuss or analyze them," *id.* at 713, the court of appeals here addressed every aspect of the district court's findings

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9/ Indeed, the court of appeals expressly noted that if the district court found Gorelick's testimony incredible, "that is its prerogative as the trier of the fact . . . ." (A. 54a).

of fact and explained in exhaustive detail exactly why they were erroneous in light of the undisputed evidence in the record. [10/]

What Penthouse complains about was not impermissible "fact-finding" by the court of appeals, but rather its having reached ultimate conclusions from the factual record which differed from the district court's. But that is exactly the proper function of the federal courts of appeals. The district court's intemperate opinion had pushed a viable savings and loan institution to the economic brink simply because it exercised the diligence its depositors and regulators expect of it. And it had jeopardized the career and reputation of a lawyer and his firm precisely because the lawyer had taken seriously his obligation to prevent his client from closing a loan without the legal protection for which it had bargained. The court of appeals redressed these wrongs. Its decision affords no basis for exercise of this Court's supervisory power.

10/ Moreover, this Court's reversal in *Icicle Seafoods* was based on the Ninth Circuit's having erroneously followed "a *de novo* standard of review" (475 U.S. at 713), rather than the Rule 52(a) "clearly erroneous" criterion employed throughout the Second Circuit's opinion here.

CONCLUSION

The petition for a writ of certiorari should be denied.

Dated: February 8, 1989

Respectfully submitted,

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Supreme Court, U.S.
FILED
MAR 13 1989
JOSEPH F. SPANIOL, JR.
CLERK

Nos. 88-1144, 88-1339

IN THE

Supreme Court of the United States

OCTOBER TERM, 1988

PENTHOUSE INTERNATIONAL, LTD. and BOARDWALK PROPERTIES, INC.,
Petitioners and Cross-Respondents,
v.
DOMINION FEDERAL SAVINGS & LOAN ASSOCIATION,
Respondent and Cross-Petitioner,
and
MELROD, REDMAN & GARTLAN, P.C., and QUEEN CITY SAVINGS & LOAN ASSOCIATION,
Respondents.

Petition For A Writ Of Certiorari To The United States Court of Appeals For The Second Circuit

PETITIONERS' REPLY BRIEF AND RESPONSE TO CROSS-PETITION FOR A WRIT OF CERTIORARI

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PETITIONERS' REPLY BRIEF AND RESPONSE TO CROSS-PETITION FOR A WRIT OF CERTIORARI[1]

When a federal court of appeals determines in a diversity case that the district court overlooked a critical legal issue, the appellate court must identify the correct legal standard under state law, and remand the case to the district court for any necessary factual findings under that standard. *Pullman-Standard* v. *Swint*, 456 U.S. 273 (1982). In this case the court of appeals did neither. In violation of *Erie R. Co.* v. *Tompkins*, 304 U.S. 64 (1938), the court of appeals, having decided that it must determine the loan commitment's expiration date, ignored controlling New Jersey law regarding the legal effect to be given that date and the parties' ability to waive or extend it through their conduct. Contrary to the holding of *Pullman-Standard*, *supra*, the court of appeals made *de novo* factual findings about the expiration date and related factual issues, instead of remanding the case for determination of those issues.

Dominion Federal Savings & Loan Association and the law firm of Melrod, Redman & Gartlan, P.C. (hereinafter "respondents") fail to confront these fundamental flaws in the decision below. Although federal appellate courts have a duty "to ascertain and apply the state law where . . . it controls decision," *Huddleston* v. *Dwyer*, 322 U.S. 232, 236 (1944), respondents do not even attempt to support the court of appeals on the ground that it actually considered the principles of New Jersey law governing contract expiration dates.[2] (Resp. Br. at 13.)

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[1] Pursuant to Rule 28.1 of the Rules of this Court, we hereby state that Penthouse International, Ltd. and Boardwalk Properties, Inc. are privately held corporations.

[2] Respondents' assertion that the court of appeals "cited unimpeachable New Jersey authority throughout its opinion" (Resp. Br. at 13) misses the point that the court never considered the law of New Jersey governing contract expiration dates. The New Jersey authority cited by the court of appeals concerned general principles of contract interpretation.

Respondents concede—contrary to what the court of appeals said—that Dominion had legal obligations to petitioners *after* the supposed March 1, 1984, expiration date of the loan commitment. (Resp. Br. at 14.) But they do not explain what those obligations were or why they were not breached through the conduct condemned by the district court. Furthermore, respondents do not address directly our contention that the court of appeals found facts for the first time on appeal and they do not even cite the *Pullman-Standard* decision.

The two serious errors of federal law committed below in this reversal of a $128.7 million judgment, the significance of this case to the rapidly developing field of "lender liability" law, and respondents' failure to stand behind the court of appeals' own analysis, make this an appropriate case for the exercise of this Court's supervisory power.[3] The Court should grant the Petition, vacate the judgment, and remand to the court of appeals with instructions to remand to the district court for factual findings under the controlling state law principles.

1. Respondents seek to downplay the significance of this case, claiming that the case "caused a stir in the lending industry" only because the district court "expressed its findings in unusually harsh language." (Resp. Br. at 2.) To the contrary, the nation's foremost business journal described the decision below as a "sweeping ruling that will help shield lenders from borrower lawsuits," and will have broad impact "[b]ecause there have been few appellate decisions to guide trial courts in this relatively new area of law, and because Second Circuit rulings are influential in business matters . . . ." Wall St. J.,

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[3] The Court's exercise of its supervisory power is especially appropriate here because improper appellate fact-finding, by definition, does not become apparent until after the court of appeals rules. "As the Court of last resort in the federal system, we have supervisory authority and therefore must occasionally perform a pure error-correcting function in federal litigation." *Florida* v. *Rodriguez*, 469 U.S. 1, 7 (1984) (Stevens, J., dissenting).

Aug. 29, 1988, at 2. The appellate court's decision was also hailed by the lending industry as "signal[ling] a new judicial approach to the law of lender liability" that emphasizes "the formal, written agreement of the parties . . . over the informal oral communications." T. Boudreau, *The Penthouse Reversal*, 2 LENDER LIABILITY REP. 1, 3 (Nov. 1988).[4] These factors, not the supposedly "harsh" tone of the district court's opinion, demonstrate the legal significance of this case and account for the great attention it has received.

2. Our Petition explained that the court of appeals ignored controlling New Jersey law when it held that "the parties' conduct in continuing to negotiate after March 1st," although "consistent with an implied extension of the expiration date," could not extend the parties' obligations because that would be "inconsistent with [the loan commitment's] clear language." (Pet. App. 30a.) From what source the court of appeals derived the legal principle embodied in that holding is impossible to tell from the opinion or from respondents' brief in opposition. The court certainly did not rely on New Jersey law, which embraces a contrary principle. New Jersey law provides that a contract expiration date is not immutable if the parties did not agree to make "time of the essence," and that even if they did, the parties' conduct can have the effect of waiving or extending the expiration date.[5] (*See* Pet. at 15-18.)

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[4] *See* W. Dennis & M. Endler, *Bank of America and Penthouse: Is the Lender Liability Pendulum Swinging Back?*, 43 CONSUMER FIN. L. Q. REP. 3 (Winter 1989) (commenting that decision below, along with a recent state court decision, "may signal a change in the judiciary's attitude regarding lender liability suits and an unwillingness to further extend the liability of lenders for requiring strict adherence to loan agreements"). *See also* R. Fries, *Mortgage Lenders Found Increasingly Accountable*, Nat'l L. J. 14 (Feb. 6, 1989).

[5] *Selective Builders, Inc.* v. *Hudson City Savings Bank*, 137 N.J. Super. 500, 349 A.2d 564, 566 (N.J. Super. Ct. Ch. Div. 1975); *Salvatore* v. *Trace*, 109 N.J. Super. 83, 262 A.2d 409, 413 (N.J. Super. Ct. App. Div. 1969), *aff'd per curiam*, 55 N.J. 362, 262 A.2d 385 (1970).

Respondents nevertheless suggest that this error is not worthy of the Court's review because it involves an "unremarkable line of New Jersey authority" which was "'well-established'" in New Jersey "years ago." (Resp. Br. at 12.) The settled nature of these New Jersey principles, however, makes the court of appeals' failure to consider them more egregious, not less. The Court has exercised its supervisory power to assure that the federal courts of appeals follow the most recent state court decisions. *See Exxon Co., U.S.A.* v. *Banque de Paris et des Pays-Bas*, ___ U.S. ___, 109 S. Ct. 299 (1988). The exercise of that power is still more appropriate when the court of appeals fails to follow well-settled state law and inexcusably breaches its duty, under *Erie*, to "ascertain and apply" the controlling state law. *Huddleston*, *supra*, 322 U.S. at 236. Our argument is not, as respondents characterize it, that New Jersey law was "misapplied." (Resp. Br. at 3.) The problem here is that the court of appeals entirely ignored New Jersey law that bore directly on the critical questions decided on appeal.

3. According to respondents, the court of appeals would have reached the same result even if it had properly applied the controlling state law. (Resp. Br. at 13-14.) But that proposition, resting on the notion that "there was no evidence to support a finding that the March 1 deadline date was mutually extended or waived" (Resp. Br. at 14), cannot be sustained.[6] The court of

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[6] Respondents offer a selective and misleading statement of the controlling New Jersey law when they assert that any waiver or extension of an expiration date "'must take the form of an agreement founded on valuable consideration'" or "'a clear, unequivocal and decisive act showing such purpose as to amount to estoppel *in pais*.'" (Resp. Br. at 14) (emphasis omitted.) This language, quoted from the *Selective Builders* decision, was accompanied by a statement that waiver of an expiration date "may be expressed or *implied* by written or oral agreement *or by conduct* indicating an intention to waive." 349 A.2d at 567 (emphasis added). Furthermore, the elements of a waiver or extension have nothing to do with the preliminary and separate question whether "time is of the essence" in a loan commitment.

appeals itself recognized that the parties' conduct "may be consistent with an implied extension of the expiration date" (Pet. App. 30a) because negotiations continued after March 1, 1984, and the court also noted that the lenders specifically chose not to terminate the loan commitment on that date.[7] (Pet. App. 18a, 30a.)

Rather than backing the plain holding of the court of appeals, respondents run away from it. According to them, the court of appeals "did *not* hold . . . that the instant a written time limit is allowed to expire, 'the lenders are thereby relieved of any further legal obligations to the borrower.'" (Resp. Br. at 14) (emphasis added.) But that is precisely what the court of appeals did hold. If the court had thought Dominion had legal obligations to Penthouse that continued after March 1, it necessarily would have identified them and explained why those obligations were not breached through conduct which the district court viewed as an "unambiguous refusal to close." (Pet. App. 88a.) The court of appeals' silence on this score shows beyond doubt that it viewed Dominion's obligations at an end on March 1.

Respondents further suggest that the court of appeals simply held that the district court could not rely on "acts by

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[7] Respondents complain that the "time of the essence" doctrine relied upon in the Petition was "not asserted in the court below." (Resp. Br. at 13.) But petitioners cited and discussed *Selective Builders*, one of the leading New Jersey cases on point. (*See* Pet. at 16 n.12.) Respondents also ignore that petitioners had no reason to anticipate that the court of appeals would select March 1, 1984, as the cut-off point for determining whether Dominion's conduct amounted to an anticipatory breach, since the district court made no finding regarding the commitment expiration date and since Dominion concedes that "the expiration date was not relied upon as Dominion's excuse for not closing." (Resp. Br. at 14.) Rather, the principal thrust of Dominion's argument below was that Penthouse was unable to satisfy the pre-closing conditions and those conditions were not waived. Brief for Defendant-Appellant Dominion Federal Savings & Loan Association, at 39-53 (Jan. 15, 1988).

Dominion and its counsel after March 1 as supposed evidence of 'anticipatory breach,'" and, astonishingly, assert that "the expiration date was not relied upon as Dominion's excuse for not closing" because "Penthouse was nowhere near ready to close." (Resp. Br. at 14.) Thus, even now, respondents eschew any reliance on the loan commitment's expiration date as the reason for Dominion's refusal to close the loan. Yet that expiration date was critical to the court of appeals' holding that there was no anticipatory breach because conduct after March 1, 1984, was "not relevant to our inquiry." (Pet. App. 34a.) The confused nature of respondents' own position, and its inconsistency with the reasoning of the court below, underscores the need for this Court's review. When a court of appeals adopts a legal theory not advanced by the appellants, and in doing so fails to apply controlling state law, that violation of the basic *Erie* rule should not go uncorrected in a case of such major legal and practical consequence.

4. We explained in our Petition that the court of appeals made an improper *de novo* factual finding when it proceeded on its own to determine the expiration date of the loan. (Pet. 20-24.) Although the court purported only to "construe the terms of relatively unambiguous documents" (Pet. App. 30a) in finding that March 1, 1984, constituted the commitment expiration date, it considered extrinsic evidence favoring its own view (ignoring other evidence to the contrary)[8] and conceded that "[t]he district court did not specifically find that the parties extended the expiration date to March 1st . . . ." (Id. at 29a.)

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[8] In our Petition (at 21 n. 19), we noted various factors indicating that the March 1, 1984, date was merely a "projected closing date" and was not even treated as an expiration date by Dominion, which was telling loan participants as late as February 6, 1984, that the loan would close "in February or *March* of 1984." (Pet. App. 108a) (emphasis added.)

In so ruling, the court below violated the clear holding of *Pullman-Standard, supra*,[9] and many other recent decisions of this Court cautioning the federal courts of appeals not to engage in appellate fact-finding.[10] The Court has not hesitated in similar cases to grant *certiorari*, and to reverse summarily and remand with instructions for the court of appeals to remand for findings of fact by the district court, and we urge the Court to do the same here. *E.g.*, *Dennison Manufacturing Co.* v. *Panduit Corp.*, 475 U.S. 809 (1986); *Lehman* v. *Trout*, 465 U.S. 1056 (1984) (remanded for findings of fact "based on new evidence if necessary").

Respondents nowhere answer our contention that the *Pullman-Standard* rule was violated. The best they can manage is the assertion that the district court "implicitly found a March 1, 1984 deadline when it concluded that the title problems 'could have been resolved in time to close the deal before March 1, 1984.'"[11] (Resp. Br. at 7.) This supposed "implicit"

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[9] "When an appellate court discerns that a district court has failed to make a finding because of an erroneous view of the law, the usual rule is that there should be a remand for further proceedings to permit the trial court to make the missing findings . . . ." *Pullman-Standard, supra*, 456 U.S. at 291.

[10] *E.g.*, *Amadeo* v. *Zant*, ____ U.S. ____, 108 S.Ct. 1771, 1780 (1988); *Icicle Seafoods, Inc.* v. *Worthington*, 475 U.S. 709 (1986); *Anderson* v. *City of Bessemer City*, 470 U.S. 564, 573 (1985); *Inwood Laboratories, Inc.* v. *Ives Laboratories, Inc.*, 456 U.S. 844, 857 n. 19 (1982).

[11] At all events, the language respondents quote from the district court's opinion regarding the parties' selection of March 1, 1984, as the projected or planned closing date says nothing with respect to the loan commitment's expiration date. Similarly, Penthouse's complaint alleged only that the loan commitment was "extended to March 1, 1984," and no issue was raised at trial that such date was either immutable or controlling. (*See* Resp. Br. at 7.) To the contrary, the evidence petitioners adduced at trial indicated that March 1 was

finding, however, cannot logically be squared with the district court's *explicit* finding that an "anticipatory breach" (by definition occurring *before* the date set for performance) occurred because of conduct "during February and March 1984." (Pet. App. 87a.) The court of appeals' opinion simply cannot be salvaged on the basis of some so-called "implicit" lower court finding.

5. Respondents seriously misconstrue our Petition, and the decision of the court of appeals, by suggesting that we are asking this Court to review the court of appeals' conclusion that certain district court findings were "clearly erroneous." (Resp. Br. at 3, 15.) The court of appeals' entire decision was premised on its legal conclusion that the petitioners' "anticipatory breach" claim could not be decided without first determining when the loan commitment was to expire. Only after the court of appeals made the *de novo* determination that the loan commitment expired on March 1, 1984, did it proceed to rule that the district court made "clearly erroneous" findings respecting petitioner's ability to satisfy pre-closing conditions by that date and the occurrence of an unambiguous refusal to close by that date. (*See* Resp. Br. at 3-4.) We are not asking this Court to review these "clearly erroneous" rulings of the court of appeals; we ask only that the legal premise of those rulings be reviewed.

6. In our Petition we argued that the court of appeals also violated the principles of *Erie* and *Pullman-Standard* when it held that Queen City Savings & Loan Association ("Queen City") had no "authority" as lead lender to waive Penthouse's exact compliance with various pre-closing conditions by ac-

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merely a "projected closing date" (Pet. at 21 n. 19; J.A. 860), and at the close of the trial the district court conformed the pleadings to the evidence. (Pet. App. 64a.) *See* Fed. R. Civ. P. 15(b). This evidence was supported by Dominion's own expert, who testified that closing dates are not controlling, which is consistent with New Jersey law and at odds with the court of appeals' decision. (Pet. at 19.)

cepting "substitute performance."[12] (Pet. at 24-26.) The authority of Queen City to accept "substitute performance" not amounting to a "material change" in the pre-closing conditions was a fact-bound issue inappropriate for *de novo* decision by the court of appeals. (Pet. at 25.) The appellate court, while ruling on the subject, also paid no heed to the New Jersey law of estoppel, which provides the legal standards for determining whether Queen City's actions were binding on the other financial institutions participating in the $97 million loan. (*Id.* at 26.)

Without the court of appeals' finding that Queen City had no "authority" to accept "substitute performance," respondents' argument that petitioners were "nowhere near ready to close" by March 1 (Resp. Br. at 14) collapses, as indeed it should. The court of appeals acted contrary to "the understanding held in much of the industry," W. Dennis & M. Endler, note 2 *supra* at 7, by holding as a matter of law that a lead lender in a large syndicate is not authorized to decide which loan conditions can be satisfied through substitute arrangements without "material" change. (Pet. App. 40a.)

7. We do not oppose the "protective" cross-petition for a writ of certiorari filed by Dominion, which seeks review of the district court's dismissal of Dominion's third-party claim against Queen City. (*See* Resp. Br. at 4 n.5.) If this Court should grant our Petition and remand the case to the court of appeals with instructions for a further remand to the district court, the district court can properly consider anew Dominion's third-party claim in light of the correct state law standards and its own factual findings.

* * *

Review of this case is warranted to assure that controlling law is applied to the facts by the judges experienced in and

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[12] Although respondents now complain that we refer to a "waiver" of pre-closing conditions as the acceptance of "substitute performance" (Resp. Br. at 5), the latter term was used repeatedly by the court of appeals itself. (*See, e.g.*, Pet. App. 11a, 12a, 41a.)

properly charged with fact-finding. No exception to the basic requirements of *Erie* and *Pullman-Standard* exists when a district court expresses itself in language branded as "intemperate" by those who have felt its sting. (Resp. Br. at 16.) Regardless whether the court of appeals harbored a different view, or simply overstepped its bounds, it was mistaken. Its error should not go uncorrected in a case of this consequence.

CONCLUSION

For the reasons stated above and in our Petition, the Petition for a writ of certiorari should be granted.

Respectfully submitted,

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Dated: March 13, 1989